Supreme Court, U.S.
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No. 09 091417

IN THE

Supreme Court of the United States

UNITED RENTALS, INCORPORATED,

Petitioner,

v.

JAMES BIGELOW ANGELL,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. In order to satisfy the elements of 11 U.S.C. § 547(b), must a bankruptcy trustee prove that the allegedly preferential transfers diminished the bankruptcy debtor's estate available for distribution to general unsecured creditors?

2. Is the contemporaneous release of contingent setoff rights or a contingent security interest in property of the estate by a third-party as a direct result of an alleged preferential transfer a valid contemporaneous exchange for new value under 11 U.S.C. § 547(*c*)(1)?

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Petitioner, United Rentals, Inc., has no parent corporation and no publicly held company owns 10% or more of its stock.

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PETITION FOR A WRIT OF CERTIORARI

United Rentals, Inc. ("United Rentals") respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The January 22, 2010 opinion of the Court of Appeals for the Fourth Circuit is reported at 592 F.3d 525 and reproduced in the appendix hereto ("App.") at 1a.

The January 22, 2009 Order of the United States District Court for the Eastern District of North Carolina affirming the judgment of the bankruptcy court is unpublished and reproduced at App. 19a.

The April 30, 2008 Order of the Bankruptcy Court for the Eastern District of North Carolina granting the Trustee's motion to amend the judgment and denying United Rentals motion to stay is unpublished and reproduced at App. 27a. The March 31, 2008 Order of the bankruptcy court granting judgment in the amount of $66,963.74 to the Trustee is unpublished and reproduced at App. 34a. The June 14, 2007 Order of the bankruptcy court granting the Trustee's motion for summary judgment, and denying in part and granting in part United Rentals' motion for summary judgment is unpublished and attached hereto at App. 39a.

The February 19, 2010, order of the Court of Appeals for the Fourth Circuit denying United Rental's petition for rehearing or rehearing en banc is reproduced at App. 51a.

JURISDICTION

The judgment of the court of appeals was entered on January 22, 2010. App. 1a. On February 19, 2010, that court denied a timely filed petition for rehearing or rehearing en banc. App. 51a. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 547(b) of the Bankruptcy Code, 11 U.S.C. § 547(b), provides:

> (b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made—
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

> (5) that enables such creditor to receive more than such creditor would receive if—
>
> > (A) the case were a case under chapter 7 of this title;
> >
> > (B) the transfer had not been made; and
> >
> > (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Section 547(c)(1) of the Bankruptcy Code, 11 U.S.C. § 547(c)(1), provides:

> (c) The trustee may not avoid under this section a transfer—
>
> > (1) to the extent that such transfer was—
> >
> > > (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
> > >
> > > (B) in fact a substantially contemporaneous exchange;

STATEMENT OF THE CASE

I. Introduction

"The Bankruptcy Code's preference section serves two goals." App. 3a. "First, it prevents companies from 'racing to the courthouse to dismember the debtor during his slide into bankruptcy.'" App. 3a. "And second, it protects 'equality of distribution among creditors of the debtor.'" App. 3a. This case is about the interplay between those Bankruptcy Code preference provisions and mechanic's lien rights under state statute or payment bond rights under the federal Miller Act, state Little Miller Acts and private payment bonds. It raises the important question how a contractor who was protected by these remedies before receiving payment can be subject to a preference claim to recover payments received, while a contractor who was not paid retains those protections and the ability to receive payment even after the debtor files bankruptcy. The Fourth Circuit's decision in this case conflicts with the decisions of other circuits and creates the inequitable and illogical scenario where a construction contractor is prejudiced by accepting payment for its work.

It is not uncommon for a construction contractor to suffer financial difficulties that threaten to stall work on construction projects because of nonpayment to subcontractors and suppliers. To limit this risk of nonpayment and the resulting consequences of delayed and higher cost construction projects, state legislatures passed mechanic's lien statutes to provide security to construction contractors on private construction projects. Similarly, the federal government recognized

the importance of assuring payment to construction contractors on public construction projects and passed the Miller Act, requiring payment bonds for the protection of construction contractors. The legislatures of every state in the country followed suit with a so-called "Little Miller Act" for the same purpose. All of these statutes recognize the economic importance of protecting construction contractors and facilitating lower priced construction projects through limitations on risks.

Despite clear conflicts with the decisions of other circuits, the Fourth Circuit's decision in this case denies that preferred status to the very creditors those laws seek to protect. The result of this decision is that, in the event of bankruptcy, a construction contractor is only protected from the risk of nonpayment if that contractor does not receive payment. An unpaid contractor is protected by these remedial mechanisms and can collect payment for its work, despite the bankruptcy. In contrast, a contractor who has been paid is prevented from pursuing these remedies and is then forced to return the payments to the debtor at a time beyond the deadlines to preserve any remedy. The paid contractor retroactively becomes unprotected. This is exactly what the state legislatures and the federal government have sought to prevent through legislation.

The consequences of this decision on the construction industry are immeasurable. The only way a construction contractor can protect itself against a later preference claim is to refuse payment from a debtor and instead actually file its payment bond claim or mechanic's lien prior to accepting payment. This works

against the very purpose of the preference provisions and promotes dismemberment of the debtor during his slide into bankruptcy. Rather than preventing the race to the courthouse, the Fourth Circuit has made it mandatory.

This Court should grant certiorari to resolve the conflicts created by the Fourth Circuit's decision and to prevent this unwarranted encroachment on the long-held protections of construction contractors established by contract, and state and federal law.

II. Factual Background

Prior to filing its bankruptcy petition on September 1, 2004, Partitions Plus of Wilmington, Inc. ("Partitions") was working as a subcontractor for Bovis Lend Lease, Inc. on a construction project known as Dosher Memorial Hospital ("Dosher Project"). Partitions enlisted United Rentals, Inc. ("United Rentals") to supply the rental equipment needed. Throughout the Dosher Project, United Rentals provided various rental equipment to Partitions on an open account and periodically received payments from Partitions. United Rentals last supplied rental equipment to Partitions for use on the Dosher Project on June 1, 2004.

During that same time, Partitions was also working as a subcontractor for EMJ Corporation on a construction project known as Mayfair Town Center ("Mayfair Project"). Partitions was similarly using rental equipment rented from United Rentals on that project. United Rentals' last supply of rental equipment to Partitions for the Mayfair project was on September 22, 2004.

On both the Dosher Project and the Mayfair Project, Partitions entered into payment bonds with United States Fire Insurance Company ("U.S. Fire") for the protection of those supplying labor, materials and rental equipment to Partitions. Under the terms of the payment bonds on these projects, United Rentals could have asserted a claim against U.S. Fire for any monies owed to United Rentals for rental equipment used on the projects. A suit against U.S. Fire on the payment bonds could have been commenced until the "expiration of the minimum period of limitation permitted by any law."

North Carolina law gives a subcontractor "a lien upon funds that are owed to the contractor with whom the . . . subcontractor dealt and that arise out of the improvement on which the . . . subcontractor worked or furnished materials." N.C. GEN STAT. §44A-18 (2010). United Rentals provided undisputed evidence that the contractors with whom Partitions dealt owed Partitions amounts greater than the amount of the alleged preferential transfers both at the time of the transfers and as of the date the petition was filed.

North Carolina law also provides a claim of lien on real property that must be filed within 120 days of the last supply of work to the project. N.C. GEN. STAT. § 44A-12 (2010). Pursuant to this statute, United Rentals had until January 20, 2005 to perfect its lien on real property rights on the Mayfair Project.[1]

1. The North Carolina lien on funds, applicable to both projects, and the North Carolina lien on real property, applicable only to the Mayfair Project are hereinafter collectively referred to as "mechanic's liens."

As of the date of the alleged preferential transfers and the date of Partitions' bankruptcy petition, United Rentals was still within any deadline to make a claim against U.S. Fire or to file mechanic's liens. For the common sense reason that it had received payment of the monies owed on these projects, United Rentals never made a claim against the bonds or filed any mechanic's liens related to either project.

III. Bankruptcy Court Proceedings[2]

On September 1, 2004, Partitions filed a chapter 11 bankruptcy petition in the Bankruptcy Court for the Eastern District of North Carolina. On November 4, 2004, the case was converted to a chapter 7 proceeding and James B. Angell was appointed Trustee for the liquidation (Mr. Angell is hereinafter referred to as the "Trustee").

On July 14, 2006, the Trustee filed a complaint in the bankruptcy court seeking to recover $75,849.40 from United Rentals pursuant to 11 U.S.C. § 547 and 11 U.S.C. § 550(a). App. 40a 41a. The bankruptcy court had jurisdiction over the Trustee's complaint pursuant to 28 U.S.C. §§ 157 and 1334. This Complaint alleged that $75,849.40 in transfers were made to United Rentals for or on account of an antecedent debt while the debtor was insolvent and that these transfers were made within 90 days of the date of the petition date.[3] App. 42a. Most

2. The discussion of the bankruptcy court proceedings is limited to those issues relevant to the question presented in this writ.

3. United Rentals did not dispute any of these allegations at summary judgment or trial.

importantly for this appeal, the Trustee further alleged that the transfers "enabled the Defendant to receive more from the Debtor than it would have received in a Chapter 7 case had the transfers not been made and the Defendant received payment on its claim to the extent provided by Title 11 of the United State Code." App. 42a.

United Rentals moved for summary judgment on the basis that the Trustee could not show that the alleged preferential payments enabled United Rentals to receive more than it would have if the transfer had not been made. App. 5a. The Trustee filed a cross-motion for summary judgment on this issue asserting that it had met its burden under § 547(b) by showing that general unsecured creditors would not receive one hundred percent of their claims from the assets of the bankruptcy estate. App. 5a.

The court ruled that the Trustee had met his burden of proof and granted the Trustee's motion for summary judgment. App. 48a. It reasoned that, while United Rentals argued it would have received payment in full from the surety had it not been paid, the court's analysis is limited to "whether in a chapter 7 liquidation there would have been enough funds to pay this creditor's claim *out of the estate*." App. 48a (emphasis added).

This matter then proceeded to trial on February 28, 2008 on United Rentals' affirmative defenses. At trial, United Rentals presented the argument that the release of its inchoate mechanic's lien rights and its rights against the payments bonds at the time of the alleged preferential transfers constituted a contemporaneous

exchange for new value under 11 U.S.C. § 547(c)(1). The bankruptcy court, relying on its own unpublished opinion issued eleven days before in *Angell v. Pennington*, Adv. Pro. 06-00148-8-AP (Bankr. E.D.N.C. March 20, 2008), set forth a two part test to determine whether such a defense existed. App. 37a. This test required that a creditor show "(1) it would have timely filed a claim against the project's payment bond and been paid in full had it not received payment from the debtor, and (2) at the time, the debtor was still owed funds by the general contractor on which the bonding company could have asserted a lien." App. 37a.

United Rentals presented undisputed evidence establishing element two of the *Angell v. Pennington* test. This evidence showed that the owners and general contractors on both projects were holding funds in excess of the alleged preferential payments both at the time of the transfers and at the time of bankruptcy petition. App. 37a.

The bankruptcy court, however, focused on the first element of its self-created test in making its decision. App. 37a-38a. It determined that because United Rentals had not established that it "would have filed a bond claim and been paid in full had it not received the preferential payment," the contemporaneous exchange for value defense of § 547(c)(1) was not available to United Rentals. App. 37a-38a.

Relying on *Precision Walls v. Crampton (In re Precision Walls)*, 196 B.R. 299 (E.D.N.C. 1996), the bankruptcy court determined that United Rentals was an unsecured creditor because it had not perfected its

lien rights prior to receiving payment from Partitions. App. 36a. The court deemed this opinion dispositive of United Rentals' 547(c)(1) defense based on the release of its inchoate mechanic's liens and found in favor of the Trustee on this argument.[4] App. 36a.

On these bases the court ruled that United Rentals did not have a valid defense to the claim of the Trustee and that the transfers could be avoided as preferential. App. 38a. On March 31, 2008, the bankruptcy court entered judgment in favor of the Trustee in the amount of $66,963.74. App. 38a.

IV. The District Court Decision

United Rentals appealed the bankruptcy court's decisions at summary judgment and trial to the United States District Court for the Eastern District of North Carolina. The district court had jurisdiction over United Rentals' appeal pursuant to 28 U.S.C. §§ 158 and 1334. On January 2, 2009, without holding oral argument, the district court issued an unpublished order affirming the bankruptcy court's decision. App. 19a-26a.

4. Throughout this litigation the Trustee has never been able to point to any case outside of the Eastern District of North Carolina that required a creditor prove that it had actually perfected mechanic's lien or bond rights prior to payment or to prove what it would have done absent payment for the purposes of a § 547(c)(1) defense. This test, which became the law of this case until Fourth Circuit review, is a creation of the bankruptcy court and district court of the Eastern District of North Carolina alone.

The district court held that the Trustee had proved that United Rentals received more than it would have had the transfers not occurred. App. 24a. This determination was based on the Fourth Circuit's opinion in *Smith v. Creative Financial Mgmt, Inc. (In re Virginia-Carolina Fin. Corp.)*, 954 F.2d 193 (4th Cir. 1992) and the statement therein that "[t]he court must focus, not on whether a creditor may have recovered all of the monies owed by the debtor from any source whatsoever, but instead upon whether the creditor would have received less than a 100% payout in [a] Chapter 7 liquidation." App. 24a. Because United Rentals would not have received one hundred percent of the allegedly preferential transfers as a general unsecured creditor *directly from the estate* in the hypothetical chapter 7, the court determined the Trustee had met its § 547(b) burden. App. 24a. The court undertook no analysis of the actual impact of the transfers on the estate. App. 24a.

The district court also affirmed the two part test created by the bankruptcy court to determine if United Rentals had § 547(c)(1) defense because of its bond rights. App. 25a.

The district court gave only a cursory review to United Rentals' release of inchoate mechanic's liens. In fact, the only determination made by the court in affirming the bankruptcy court summary judgment order was that "Appellant is an unsecured creditor because it failed to file notice." App. 24a. Like the bankruptcy court, the district court reached this conclusion by reference to its own decision in *Precision Walls v. Crampton (In re Precision Walls)*, 196 B.R. 299 (E.D.N.C. 1996). App. 24a.

On these bases, the district court affirmed the bankruptcy court's grant of summary judgment to the Trustee and denial of United Rentals' contemporaneous exchange for new value defense.

V. The Court of Appeals Decision

United Rentals then appealed to the Fourth Circuit Court of Appeals arguing that the Trustee failed to meet its burden of proof under 11 U.S.C. § 547(b) and that United Rentals had established a defense pursuant to 11 U.S.C. § 547(c)(1). The Fourth Circuit had jurisdiction over United Rentals' appeal pursuant to 28 U.S.C. § 158.

Looking first at the question of whether the Trustee had met it burden of proof under § 547(b), the Fourth Circuit, like the district court before it, relied on its decision in *Virginia-Carolina Financial Corporation* to reason that the proper analysis is not what the specific creditor would have received had the transfers not been made, but what the creditor would have received as a general unsecured creditor *directly from the bankruptcy estate* had the transfer not been made. App. 9a-10a. On this basis, the court affirmed the holding below. App. 9a-10a, 18a.

Looking next at the § 547(c)(1) defense argued by United Rentals, the court the considered the "indirect transfer theory." App. 10a-17a. The Fourth Circuit did not discuss the bankruptcy court's two-element test. *See generally* App. 1a-18a. Rather it based its decision on the fact that "the Surety never obtained any lien that it could release." App. 13a. Under this reasoning, the

necessary consideration is whether the surety held a lien at the time of the payment, not whether United Rentals could have and would have made a claim against the payment bonds. App. 13a. As the allegedly preferential $66,963.74 was paid to United Rentals by Partitions rather than U.S. Fire, no such lien existed and United Rentals had no contemporaneous exchange for new value defense based upon an indirect transfer. App. 14a.

Unlike the district court, the Fourth Circuit also considered United Rentals' inchoate mechanic's liens in the context of the contemporaneous exchange for new value defense. The court reasoned that "United [Rentals] did not have a security interest to release because it never filed the mechanic's lien claim necessary to obtain such an interest." App. 15a. In support of this position, the court reviewed the North Carolina mechanic's lien statutes and determined that the "North Carolina's mechanic's lien statutes grant a supplier of labor and material only *the right to file a claim of lien* on real property." App. 16a. (emphasis in original). The court then held that, because United Rentals had nothing more than a right to file a lien and had not exercised that right before payment, it had nothing to release at the time of the transfers and therefore no defense under 11 U.S.C. 547(c)(1). App. 16a-17a.

United Rentals filed a timely petition for rehearing or rehearing en banc, which the court denied on February 19, 2010. App. 51a.

REASONS FOR GRANTING THE PETITION

I. The Decision Below Conflicts with the Decisions of Other Circuit Courts

The petition should be granted because the Fourth Circuit's opinion conflicts with the decisions of other circuit courts. *See* S. Ct. Rule 10(a). Because of this conflict, the protection afforded a construction contractor by a payment bond or mechanic's lien statutes when a bankruptcy intervenes will vary depending on the geographical location of the construction project. This Court should not allow this inconsistent application of bankruptcy law and the resulting confusion to exist, and should grant certiorari.

A. The decision of the Fourth Circuit conflicts with decisions of the Sixth Circuit requiring a showing that the bankruptcy estate was diminished for a transfer to be preferential under 11 U.S.C. § 547(b).

Under the Bankruptcy Act, it was unquestionable that a transfer had to diminish the estate to be avoided as preferential. *See Nat'l Bank of Newport v. Nat'l Herkimer County Bank*, 225 U.S. 178, 184, 32 S. Ct. 633, 56 L. Ed. 104 (1912) ("the act condemns, . . . the appropriation by the insolvent debtor of a portion of his property to the payment of a creditor's claim, so that thereby the estate is depleted and the creditor obtains an advantage over other creditors"); *Bailey v. Baker Ice Machine Co.*, 239 U.S. 268, 274, 36 S. Ct. 50, 60 L. Ed. 275 (1915) ("It therefore is plain that § 60b [of the Bankruptcy Act] refers to an act on the part of a

bankrupt whereby he surrenders or encumbers his property or some part of it for the benefit of a particular creditor and thereby diminishes the estate").

In twenty-plus years of precedent, the Sixth Circuit has retained this element, holding that to satisfy § 547(b) a trustee must show that the alleged preferential transfers diminish the estate available to unsecured creditors. *See Chase Manhattan Mortgage Corp. v. Shapiro (In re Lee)*, 530 F.3d 458, 464 (6th Cir. 2008) ("Although § 547(b) does not expressly make diminution of the estate an element of a preference claim, diminution is understood to be a requirement as a result of § 547(b)(5)'s improvement-in-position test"); *Stevenson v. Leisure Guide of America, Inc. (In re Shelton Harrison Chevrolet, Inc.)*, 202 F.3d 834, 836-37 (6th Cir. 2000) ("Specifically, the bankruptcy trustee may avoid any transfer of the debtor's property to a creditor . . . that diminishes the estate") (internal quotation marks omitted); *McLemore v. Third National Bank (In re Montgomery)*, 983 F.2d 1389, 1394 (6th Cir. 1993) ("We agree, of course, that a voidable preference necessarily depletes the debtor's estate; without such a depletion, there cannot be a voidable preference"); *Waldschmidt v. Mid-State Homes, Inc. (In re Pitman)*, 843 F.2d 235, 238 (6th Cir. 1980) (stating that § 547(b) "declares that the bankruptcy trustee 'may avoid any transfer' of the debtor's property to a creditor 'for or on account of an antecedent debt owed by the debtor before such transfer was made' that diminishes the estate or creates an inequality among classes of creditors").

In its 2008 opinion in *In re Lee*, the Sixth Circuit could not have been clearer that dimunition of the estate is a necessary element of § 547(b). There the court wrote, "[t]he concept here is the same as the idea developed in old Supreme Court opinions under old bankruptcy acts—that a voidable preference must 'impair,' or 'diminish,' the estate." *In re Lee*, 530 F.3d at 464. Although not as explicit, the Eleventh Circuit has also deemed it necessary under § 547(b) to analyze whether an alleged preferential payment diminished the estate. In *Bank of America N.A. v. Mukamai (In re Egidi)*, 571 F.3d 1156 (11th Cir. 2009), the Eleventh Circuit extensively analyzed the effect of a transfer on the debtor's estate, to determine whether the bankruptcy trustee had satisfied § 547(b). *Id.* at 1161. The court ultimately determined that "[b]ecause the transfer was within the control of . . . the debtor, and the transfer diminished the assets in the estate available to other creditors, the transfer was a preference, which could be avoided by the trustee." *Id.* at 1162.

Similarly, the Eighth Circuit in *Wells Fargo Home Mortgage, Inc. v. Lindquist*, 592 F.3d 838 (8th Cir. 2010), performed an analysis of whether the alleged preferential transfer diminished the estate to determine whether § 547(b)(5) was satisfied. *Id.* at 844-45. Ultimately the court concluded that "the transfer of the mortgage to [creditor] diminished the bankruptcy estate" and affirmed the holding of the bankruptcy court that the trustee had satisfied § 547(b)(5). *Id.* at 845.

The Fifth, Seventh and Tenth Circuits also continually include diminishment principles in § 547(b) elements. *See Caillouet v. First Bank & Trust (In re Entringer Bakeries Inc.)*, 548 F.3d 348 (5th Cir. 2008) (noting that the earmarking doctrine is based on the concept that the transfer "in no way diminishes the debtor's estate."); *Coral Petroleum, Inc. v. Banque Paribas-London*, 797 F.2d 1351, 135 (5th Cir. 1986) ("For the preference to be voided under section 547, it is essential that the debtor have an interest in the property transferred so that the estate is thereby diminished") (internal quotation marks omitted); *Warsco v. Preferred Technical Group*, 258 F.3d 557, 564 (7th Cir. 2001) (noting that "[c]ourts considering [§ 547(b)] have focused on whether the transfer diminished the debtor's estate"); *In re Smith*, 966 F.2d 1527, 1535 (7th Cir. 1992) ("But courts have also long held that to be avoidable, transfers must result in a depletion or diminution of the debtor's estate"); *Parks v. FIA Card Services, N.A. In re Marshall)*, 550 F.3d 1251, 1257-58 (10th Cir. 2008) (considering whether the estate was diminished in determining whether § 547(b) was satisfied).

The Fourth Circuit disagrees. Before the Fourth Circuit and the lower courts, United Rentals argued that the Trustee had failed to meet its burden of proof under 11 U.S.C. § 547(b) because it had not shown that the alleged preferential transfer diminished the estate available to the unsecured creditors of Partitions. This argument was based on this Court's decision in *Pearlman v. Reliance Insurance. Company*, 371 U.S. 132, 83 S. Ct. 232, 9 L. Ed. 2d 190 (1962), where it was held that a surety on a construction project has an equitable lien against funds owed to the bond principal. *Id.* at 141-42. Under the *Pearlman* decision, a payment

by U.S. Fire to United Rentals would have resulted in an equivalent secured claim against the estate by U.S. Fire. *See id.* ("since the surety in this case has paid out more than the amount of the existing fund, it has a right to all of it"). United Rentals established at trial that this secured claim held by U.S. Fire would have been fully secured by assets of the estate. As a result, the alleged preferential transfer would not cause any decrease in the estate available for distribution to unsecured creditors relative to the value of the estate that would have been available had the payments not been made.

In response to this argument, the Fourth Circuit reasoned that a court need not determine the actual effect of allegedly preferential transfers on the diminution of the estate. App. 9a-10a. Rather the Fourth Circuit and the lower courts limited their analysis to what United Rentals would have been paid directly from the estate as a general unsecured creditor in the hypothetical Chapter 7 distribution of § 547(b). App. 9a-10a. This analysis is admittedly consistent with the Ninth Circuit's decision in *Committee of Creditors Holding Unsecured Claims v. Koch Oil Company (In re Powerine Oil Company)*, 59 F.3d 969 (9th Cir. 1995). There, Judge Kozinski determined that such a limited analysis was appropriate despite the illogical outcome upon its application. *Id.* at 971, 973 ("Can an unsecured creditor be better off when the debtor defaults rather than paying off the debt? Yes: Law can be stranger than fiction in the Preference Zone").[5]

5. The panel in *Powerine* could not reach a consensus on this very issue. Judge Farris authored a dissent, stating "[t]he plain language of the statute does not limit consideration to funds from the [debtor's] estate." *In re Powerine Oil Company*, 59 F.3d at 974.

Both the Fourth Circuit in reaching its decision in this matter and the Ninth Circuit in *Powerine* turn to a Fourth Circuit decision that does not support their conclusions and is not in conflict with the Sixth Circuit. In *Smith v. Creative Financial Mgmt, Inc. (In re Virginia-Carolina Fin. Corp.)*, 954 F.2d 193 (4th Cir. 1992), much like in the current case, the creditor could have made a claim against a third party for payment of its debt had it not received payment from the debtor. *Id.* at 195. Unlike the current case, that third party would not have anything more than an unsecured claim against the debtor's estate or estate assets. *Id.* at 198. Because holding otherwise would result in a diminishment of the estate available for distribution to unsecured creditors, the *Virginia-Carolina Financial Corporation* court determined that the bankruptcy trustee had met its burden of proof under § 547(b)(5). *See id.* at 199 (stating that the preferential transfer was "at the expense of the debtor's other creditors").

In support of this holding, the *Virginia-Carolina Financial Corporation* court wrote, "[t]he court must focus, not on whether a creditor may have recovered all of the monies owed by the debtor from any source whatsoever, but instead upon whether the creditor would have received less than a 100% payout in [a] Chapter 7 liquidation." *Id.* Both the Fourth and Ninth Circuits have used this language as a basis for analyses that do not consider the actual effect of the transfer on the diminution of the estate but instead require comparison of the transfer to payment as a general unsecured creditor in a direct distribution from the bankruptcy estate. To say that the court must not focus on whether a creditor may have recovered all of the monies "from

any source whatsoever," however, does not mean that there is only *one* source of funds shielded from preference attack, a distribution to general unsecured creditors directly from the bankruptcy estate. The critical question instead is whether this particular creditor could have received the same payment in a chapter seven liquidation and whether the estate was diminished by the prepetition transfer. This misapplication of the *Virginia-Carolina Financial Corporation* court's opinion is in direct conflict with precedent of the Sixth Circuit requiring a trustee to establish that a bankruptcy transfer was at the expense of other creditors to be preferential.

The Ninth Circuit in *Powerine* relies on a pre-Bankruptcy Code decision from the Eight Circuit stating that "the key factor in determining whether a payment is a preference is the 'percentage . . . [creditors'] claims are entitled to draw out of the estate of the bankrupt.'" *In re Powerine Oil Company*, 59 F.3d at 972 (bracketed material in original) (emphasis omitted). The 1902 decision cited, *Swarts v. Fourth National Bank*, 117 F. 1 (8th Cir. 1902), does not answer the question whether a payment that eliminates the secured claim of a third party is a preference. In fact, there the Eight Circuit extensively analyzed the diminishing effect the preferential transfer had on the debtor's estate. *Id.* at 4-7 (noting that the third party would have an unsecured claim against the bankruptcy estate if called upon to pay the creditor). The statements relied on by the Ninth Circuit are merely an acknowledgment that the transfers were preferential because they would diminish the estate.

The Fourth Circuit cites the late Professor Countryman for the premise that "the court must focus, not on whether a creditor may have recovered all of the monies owed by the debtor *from any source whatsoever*, but instead upon whether the creditor would have received less than a 100% payout in a Chapter 7 liquidation." *In re Virginia-Carolina Fin. Corp.*, 954 F.2d at 199. In turn, Professor Countryman looked to this Court's decision in *Palmer Clay Products Co. v. Brown*, 297 U.S. 227, 80 L. Ed. 655, 56 S. Ct. 450 (1936) for his analysis relied on by the Fourth Circuit. *See* Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 Vand. L. Rev. 713, 735-37 (1985) ("most courts have had no difficulty in reading section 547(b)(5) as incorporating the rule of Palmer Clay Products"); *Palmer Clay Products*, much like *Virginia-Carolina Financial Corporation* and *Swarts*, did not present a conflict between diminishment of the estate and the source of payment. *See generally Palmer Clay Products Co. v. Brown*, 297 U.S. 227, 80 L. Ed. 655, 56 S. Ct. 450 (1936). *Palmer Clay Products* involved a bilateral transaction where the source of the transfers was never a concern. *Id.* at 227-28. In fact, even attempting to use the language of the decision to reach the conclusion by the Fourth Circuit in this case requires a very creative reading of this Court's opinion. *See id.* at 229 ("Whether a creditor has received a preference is to be determined . . . by the actual effect of the payment as determined when bankruptcy results"). The primary issue in *Palmer Clay Products* was whether the analysis of preferential effect was to be made based upon the transfer date or the petition date. *Neuger v. United States (In re Tenna Corporation)*, 801 F.2d 819, 822 (6th Cir. 1986). The source of the alleged preferential payments was not an issue. *See id.*

A question in this case is whether diminution of the estate remains an element of § 547(b) of the Bankruptcy Code and whether the transfer must be compared only to payment as a general unsecured creditor in a direct distribution from the bankruptcy estate. The Sixth Circuit has declared that dimunition remains an element. The Fifth, Sixth, Seventh, Eighth Tenth and Eleventh Circuits similarly continue to apply the concept of diminishment of the estate to § 547(b). The Fourth and Ninth Circuits have found § 547(b) satisfied when the estate would not be diminished by the transfers. This Court should grant the writ of certiorari to resolve this confusion.

B. The decision of the Fourth Circuit conflicts with decisions of the Fifth and Ninth Circuits that an indirect transfer that does not diminish the estate is a valid contemporaneous exchange for new value defense under 11 U.S.C. § 547(c)(1).

The Ninth Circuit considered a remarkably similar case to the current case and reached an opposite result in *O'Rourke v. Seaboard Surety Company (In re E.R. Fegert, Inc.)*, 887 F.2d 955 (9th Cir. 1989) (hereinafter cited as "*In re E.R. Fegert II*"). In the instant opinion, the Fourth Circuit wrote that it had reached its decision "without deciding the correctness of the *Fegert* court's conclusion that the release of the surety's security interest in that case constituted 'new value' contemporaneously received by the debtor." App. 13a. The opinion of the Fourth Circuit, however, does not draw any meaningful distinction between the Ninth Circuit's decision in *Fegert* and the instant case, which are in direct conflict.

In *Fegert*, the debtor contracted with the creditors for the construction of roads. 887 F.2d at 956. Pursuant to the requirements of the Miller Act, the debtor executed a payment bond for the protection of creditors. *Id.* The debtor defaulted on payments to the creditors, causing the creditors to file suits against both the debtor and the payment bond surety. *Id.* Prior to trial, both the surety and the debtor made payments to both creditors and the pending actions were dismissed. *Id.*

After the debtor filed bankruptcy, the trustee filed suit against the creditors seeking to avoid the payments from the debtor as preferential. *Id.* The bankruptcy court granted the creditors' motions for summary judgment based upon 11 U.S.C. § 547(c)(1). *O'Rourke v. Coral Construction, Inc. (In re E.R. Fegert, Inc.)* 88 B.R. 258, 259 (B.A.P. 9th Cir. 1988) (hereinafter cited as "*In re Fegert I*"). On appeal, the Bankruptcy Appellate Panel ultimately affirmed the bankruptcy court. *Id.* at 260. They reasoned that the allegedly preferential transfers released the *contingent* security interest in property of the estate held by the surety. *Id.* This constituted new value under 11 U.S.C. § 547(c)(1) that was released to the estate at the time of the transfers. *Id.*. The Ninth Circuit Court of Appeals affirmed the bankruptcy appellate panel on the same grounds. *In re E.R. Fegert II*, 887 F.2d at 959.

When compared with the current case, the factual similarities are striking. The creditors in *Fegert* and United Rentals in the instant case contracted with a construction contractor on specific construction projects. Both the creditors in *Fegert* and United Rentals in the instant case were valid claimants under payment bonds

executed by their debtors. Neither the creditors in *Fegert* nor United Rentals were paid the alleged preferential transfers by the surety. Both the creditors in *Fegert* and the current case were paid by the respective debtors, making payment from the surety unnecessary.

In reviewing the *Fegert* opinion, the Fourth Circuit explicitly noted that a surety does not have an equitable lien until such time as the surety pays the claimant. App. 12a. This is an accurate analysis of *Fegert*. Both opinions make clear that a surety's equitable lien arises *only* upon payment by the surety to the claimants.

The Fourth Circuit then determined that it need not decide the correctness of the Ninth Circuit's decision because of a factual difference in the cases that rendered them distinguishable. App. 13a. This distinction—in the words of the Fourth Circuit—is that the Ninth Circuit reached its conclusion because the allegedly preferential payments in that case caused the "release of the surety's security interest." App. 13a. This statement is shocking, because the Fourth Circuit previously stated that "[t]he Ninth Circuit reasoned that if the debtor had not paid the debt in full, the subcontractors would have been paid by the surety, which *then would have had an equitable lien* against the funds owed the debtor by the owner." App. 12a (emphasis added).

The Ninth Circuit Bankruptcy Appellate Panel in *Fegert I* was explicit in noting that the surety did not have a security interest in property of the estate because the surety had not paid the creditors. It wrote:

> In this case *the surety did not make the payments in question to the subcontractors.* Instead the payments were made pre-petition by the Debtor as part of a tripartite agreement under which the subcontractors released their claims against [the surety] in exchange for payments directly from the Debtor. Under these circumstances, *the Panel does not find that the fact that the surety did not actually make the payments to the subcontractors requires the application of a different equitable rule.* If the Debtor had not made the payments to [the creditors], then [the surety] would have been called upon to advance the funds and then exercise its lien rights against payments due or to become due to the Debtor.

In re Fegert I, 88 B.R. at 260 (emphasis added).

In both the instant case and *Fegert*, the surety did not have an equitable lien against the contract balance for the allegedly preferential transfers at the time of those transfers. Consequently, the purported factual distinction identified by the Fourth Circuit—that "the surety never obtained any lien it could release"—is actually a similarity. If the only relevant question is whether the surety actually possessed an equitable lien to be released at the time of the transfers, the outcome in both these cases would necessarily be the same. In contrast, the outcomes could not be more in conflict. The Fourth Circuit's decision in this case is a wholesale rejection of the *Fegert* decision.

In similar cases, both the Fifth and Ninth Circuits have affirmed the validity of the indirect transfer theory. These cases were both instances where the value of the third party security interest in the property of the estate was contingent upon the possible future enforcement of "mere contract claims" by the preference defendant against that third-party. In *Gulf Oil Corporation v. Fuel Oil Supply & Terminaling, Inc. (In re Fuel Oil Supply & Terminaling, Inc.)*, 837 F.2d 224 (5th Cir. 1988), the Fifth Circuit allowed a contemporaneous exchange defense when the preference defendant had *unsecured contract claims* against a third party bank. *See id.* at 229 (noting that the creditor could have drawn on letters of credit and that the bank had security rights in the debtor's assets based upon those letters of credit). The value of those security rights was contingent upon the preference defendant making a claim against the bank under the terms of the letter of credit. *Id.* The Fifth Circuit assumed that "[u]pon Bankruptcy, had [the debtor] not performed, the [preference defendant] would have drawn on the letters of credit and the Banks would have been entitled to the collateral or its value." *Id.* Because the estate was not diminished by the transfers, the court held that they could not be avoided as preferences. *Id.* at 230.

In *Powerine*, the Ninth Circuit came to the same result. There the court reasoned that there was an "automatic release of collateral."

> The Fifth Circuit held [in *In re Fuel Oil Supply & Terminaling, Inc.*] that the payment was protected by the contemporaneous exchange for new value exception, reasoning that, when

> the debtor paid the creditor, the banks' exposure under the letters of credit was reduced by a corresponding amount. The banks' *contingent* reimbursement claim against the debtor's assets was thereby released, *giving the debtor new value.* "This outcome is consistent with the principle underlying § 547(c)(1)," the Fifth Circuit noted, "*because the release of the debtor's collateral offsets the transfer to the creditor, thereby resulting in no depletion to the debtor's estate*"
>
> . . . When [the debtor] paid [the preference defendant] directly, [the bank's] exposure under the letters of credit was reduced by a corresponding amount, and its *contingent claim* against [the debtor's] assets *was thereby released*, but only to the extent the claim was secured. Thus, [the debtor] received new value equal to the amount of the secured portion of [the bank's] reimbursement claim.

In re Powerine Oil Co., 59 F.3d at 973 (emphasis added).

Much like U.S. Fire's security interest in this case is contingent on U.S. Fire making payment on the payments bonds, in both *Fuel Oil Supply* and *Powerine* the value of the security interest released was contingent on payment by the third party. In all these cases, there never was a payment by the third party because the allegedly preferential payment intervened. Thus, the Fifth and Ninth Circuits have held that transfers which automatically released *mere contract rights* against a third party and caused the simultaneous

release of *contingent* security rights of that third party against assets of the estate were not preferential. The decision by the Fourth Circuit in the instant case is in conflict with these decisions by the Fifth and Ninth Circuits.

C. The Fourth Circuit's decision is in conflict with decisions of this Court requiring deference to state courts' determinations of state created lien rights and in conflict with decisions of the Second and Ninth Circuits stating that transfers that release inchoate mechanic's lien rights are not preferential

In reviewing whether a lien created by state law is inchoate, this Court has traditionally accorded great deference to state courts. *See United States v. Security Trust & Savings Bank*, 340 U.S. 47, 49-50 (1950) ("if the state court itself describes the lien as inchoate, this classification is practically conclusive" (internal quotation marks omitted)). The North Carolina Supreme Court has on at least three occasions defined the materialmen and mechanic's liens created by North Carolina statute as "inchoate." *See Frank H. Conner Co. v. Spanish Inns Charlotte, Ltd.* 294 N.C. 661, 667 (1978) ("The lien provided for by G.S. 44A-8 is inchoate until perfected by compliance with G.S. 44A-11 and -12, and is lost if the steps required for its perfection are not taken in the manner and within the time prescribed by law"); *Nat'l Sur. Corp. v. Sharpe*, 236 N.C. 35, 48 (1952) ("G.S. 44-1 gives a contractor an inchoate lien upon a building and the lot on which it is situated"); *Equitable Life Assurance Soc'y v. Dunn*, 234 N.C. 347, 352 (1951) ("A contractor's lien on real property is

inchoate until perfected by compliance with legal requirements").

The Fourth Circuit held that United Rentals had only a "right to file a mechanic's lien," with the tacit implication that this "right" is something less than an inchoate lien. App. 16a. As a result, the Fourth Circuit's decision conflicts with the precedent of the North Carolina Supreme Court and ignores the deference to those decisions required by this Court.

This failure to adhere to this Court's precedent and the resulting mischaracterization of United Rentals inchoate liens allowed the Fourth Circuit to circumvent long existing precedent from other circuits. The Second and Ninth Circuits have held that transfer payments that automatically released inchoate mechanic's liens were not preferential. In *Ricotta v. Burns*, 264 F.2d 749 (2d Cir. 1959) as in the instant case, it was conceded that the defendant *could have* filed a mechanic's lien at the time each payment was made. The court noted that:

> neither the filing nor the enforcement of such a lien would have constituted a preference. Moreover, *had the liens been filed*, payment merely discharging them, without improving the creditor's position as against the general creditors of the bankrupt, would likewise have been immune from attack. *It would be absurd to treat differently payments for the same debts obtained without filing liens, and the law does not do so.* Consistent with common sense the courts have upheld payments where at the time the payments were made the

> creditor could have equally protected himself by filing a nonpreferential lien. . . .
>
> The sole purpose of filing these liens is to secure payment. *Surely receipt of payment itself should not be less secure than the lien which could have secured it.* Moreover, the essence of a preference is that it depletes the bankrupt's estate available to remaining creditors. *Where the payment merely avoids the bite of a lien which the trustee could not have successfully attacked, no such depletion occurs.*

Id. at 750 (emphasis added) (internal citations omitted).

In a later case, the Second Circuit reaffirmed this holding stating that "where a material man could have filed liens for building materials furnished the bankrupt and the filing or enforcement of the lien would not have constituted a preference, the court would treat payments for the debts *as if liens had been filed.*" *Miller v. Wells Fargo Bank International Corp.*, 540 F.2d 548, 565 (2d Cir. 1976) (emphasis added).

The Ninth Circuit has similarly held that a transfer made "in discharge of a California inchoate mechanic's lien may not be avoided by the Trustee as a preference." *Greenblatt v. Utley*, 240 F.2d 243, 244 (9th Cir. 1956). The court determined that the preference defendant held an inchoate lien at the time of the transfer, the "filing of which was not required by statute until some time [after the transfer]." *Id.* at 246. Since the time for perfecting defendant's lien had not expired, the

defendant accepted the payment "in satisfaction" of inchoate mechanic's lien right and payments were therefore not avoidable as a preference. *Id.* at 244-247.

The Fourth Circuit has rejected and is in conflict with these decisions of the Second and Ninth Circuits holding that there is no preferential transfer if unperfected state law inchoate mechanic's lien rights are released, resulting in no diminution of the estate.

II. The decision below implicates a recurring question of national importance and conflicts with federal and state law

The Fourth Circuit has all but eliminated the protection provided to construction contractors by the federal Miller Act, state law Little Miller Acts or private payment bonds in the event of bankruptcy. A contractor who receives payment from their contract debtor is denied the protections of those statutes or bonds, if that contractor files bankruptcy within ninety days of making payment to their creditor. This result undermines the intent of those statutes and the important public interests that gave rise to their passage.

"The Miller Act was designed to provide an alternative remedy to the mechanics' liens ordinarily available on private construction projects." *J.W. Bateson Co., Inc. v. United States ex rel Board of trustees of the National Automatic Sprinkler Industry Pension Fund*, 434 U.S. 586, 589, 98 S. Ct. 873, 875, 55 L. Ed. 2d 50, 55 (1978); *see also F.D. Rich Co., Inc. v. United States ex rel Industrial Lumber Co., Inc.*, 417 U.S. 116, 122, 94 S. Ct. 2157, 2161, 40 L. Ed. 2d 703, 709 (1974) ("The

Miller Act was intended to provide an alternative remedy to protect the rights of these suppliers."). "The Miller Act . . . is highly remedial in nature." *United States ex rel Sherman v. Carter*, 353 U.S. 210, 216, 77 S. Ct. 793, 796, 1 L. Ed. 2d 776, 782 (1957). "It is entitled to a liberal construction and application in order properly to effectuate the Congressional intent to protect those whose labor and materials go into public projects." *Id.* The Act executes that policy by providing a surety who "must make good the obligations of a defaulting contractor to his suppliers of labor and material." *Id.* at 217. Similarly, state legislatures throughout the country have passed Little Miller Acts with the same intent.

In *Fegert*, the Ninth Circuit considered a contractor who could have collected on a Miller Act payment bond, but was instead paid by the contract debtor who later filed bankruptcy. There the court reached the common-sense conclusion that a creditor should not be prejudiced by its receipt of payment and thus be denied the protections of the Miller Act created by Congress to specifically protect contractors. *See In re E.R. Fegert II*, 887 F.2d at 959 (holding that the payments are not avoidable as preferences).

At least two circuits have held that the reasoning applied by this Court in *Pearlman* applies to non-Miller Act bonds as well. *First Indemnity of America Insurance Company v. Modular Structures, Inc. (In re Modular Structures, Inc.)*, 27 F.3d 72, 80 (3d Cir. 1994) ("There is also nothing in the Court's reasoning in *Pearlman* that implies that its doctrine should apply only to public contracts"); *Framingham Trust*

Company v. Gould-National Batteries, Inc., 427 F.2d 856, 858 (1st Cir. 1970) ("We see no reason why that same equitable obligation to the laborers and materialmen should not exist on the part of the non-government owner, who receives the same benefit from those suppliers — construction work and materials — as did the government in the aforementioned cases.") The instant case does not directly involve a payment bond executed pursuant to the Miller Act or any Little Miller Act, but the reasoning involved is identical. The Fourth Circuit has decided, however, that § 547 eliminates the protection of a bond claimant creditor who received payment of the debt and as a result never made a bond claim, even if the creditor still had bond rights at the time of the transfer and even if the relevant owners and general contractors were holding sufficient funds at the time of the transfer that there was no diminution of the bankruptcy estate available for distribution to general unsecured creditors.

The decision of the Fourth Circuit flies directly in the face of the goals of the preference section of the Bankruptcy Code. These two goals, as expressed by the Fourth Circuit are to prevent companies from "racing to the courthouse to dismember the debtor during his slide into bankruptcy" and to "protect the equality of distribution among the creditors of the debtor." App. 3a (internal quotation marks omitted). The decision of the Fourth Circuit, however, requires construction creditors to race to the courthouse before they actually receive payment, if the creditor wishes to retain their payment bond or state law mechanic's lien rights.

The public policy ramifications of this decision are enormous. To protect themselves, any construction supplier or contractor would need to refuse payment and instead file mechanic's lien or bond claims as an ordinary practice to avoid bankruptcy preference claims, even if there is no reason to suspect an imminent bankruptcy. These mechanic's liens or bond claims would then be released on receipt of payment. This would disrupt projects and business relations, generate legal fees and consume court resources, while promoting, rather than preventing, dismemberment of the debtor during his slide into bankruptcy.

Paradoxically, a debtor that really wanted to avoid paying a certain lien or bond creditor could accomplish that end by *actually paying* the creditor right before bankruptcy.

> The Debtor/Contractor could, in effect, avoid payment of any or all subcontractors by paying them within 90 days of bankruptcy and then simply waiting until 60 days after substantial completion of the work before filing the action to recover the preference. By doing so, the subcontractor could effectively be denied its lien rights.

In re Dick Henley, Inc., 38 B.R. 215 (Bankr. S.D.N.Y. 1984). The *Dick Henley* court recognized that the reasoning applied by the Fourth Circuit creates a legal framework that in reality is itself preferential.

Under the Fourth Circuit decision, an unpaid contractor is unquestionably better off than a paid contractor when a bankruptcy intervenes, where the payment bond or mechanic's lien rights could have been successfully enforced post bankruptcy petition. Consequently, contractors will be forced to take steps to protect their status, even when those actions defy common sense and threaten to wreak havoc on the construction industry. A decision with such clear and severe consequences warrants this Court's review.

CONCLUSION

For the foregoing reasons, United Rentals, Inc., respectfully requests that the Court grant its petition for a writ of certiorari.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT DECIDED JANUARY 22, 2010

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 09-1209

UNITED RENTALS, INCORPORATED,

Plaintiff-Appellant,

v.

JAMES BIGELOW ANGELL,

Trustee-Appellee.

Appeal from the United States District Court
for the Eastern District of North Carolina, at Raleigh.
Terrence W. Boyle, District Judge.
(7:08-cv-00097-BO)

Argued: December 2, 2009

Decided: January 22, 2010

Before TRAXLER, Chief Judge, and SHEDD and DAVIS, Circuit Judges.

Appendix A

OPINION

TRAXLER , Chief Judge:

United Rentals, Inc. ("United") appeals a district court order affirming a bankruptcy court judgment allowing the bankruptcy trustee to avoid and recover certain payments made to United during the 90 days prior to the bankruptcy petition. We affirm.

I.

Partitions Plus of Wilmington, Inc. ("the Debtor") filed a Chapter 11 bankruptcy petition on September 1, 2004. The case was subsequently converted to a Chapter 7 proceeding. Prior to its bankruptcy filing, the Debtor had subcontracted in several construction projects, and United had subcontracted with the Debtor to supply rental equipment. The Debtor executed payment and performance bonds with United States Fire Insurance Company ("the Surety"), for the construction of several of these projects.

In the 90-day period prior to the Debtor's bankruptcy filing, the Debtor made three payments to United totaling $ 75,849.40 for amounts owed for United's prior provision of rental equipment and parts ("the transfers"), $ 67,470.60 of which was for bonded projects. The bankruptcy trustee ("the Trustee") filed this action seeking to avoid and recover the transfers as preferential payments. *See* 11 U.S.C.A. § 547(b) (West 2004 & Supp. 2009). United denied that the transfers

were avoidable and asserted defenses under 11 U.S.C.A. § 547(c)(1), (3), and (4) (West 2004 & Supp. 2009).

The Bankruptcy Code's preference section serves two goals. First, it prevents companies from "racing to the courthouse to dismember the debtor during his slide into bankruptcy." *Harman v. First Am. Bank of Md. (In re Jeffrey Bigelow Design Group, Inc.)*, 956 F.2d 479, 487 (4th Cir. 1992) (internal quotation marks omitted). And second, it protects "equality of distribution among creditors of the debtor." *Id.* (internal quotation marks omitted). Except as specified in the Bankruptcy Code, a bankruptcy trustee may avoid as a preference a transfer made by an insolvent debtor to a creditor on account of an antecedent debt within 90 days before the date of the filing of the bankruptcy petition if a certain condition is satisfied.[1] *See* 11 U.S.C.A. § 547(b). That condition is that the transfer to be avoided must have enabled the creditor to receive more than it would have received from the debtor's Chapter 7 bankruptcy on the debt the transfer extinguished if the payment sought to be avoided had never been made. *See* 11 U.S.C.A. § 547(b)(5).

Section 547(c) provides exceptions for certain preferential transfers, the avoidance of which would not further the purposes of § 547(b). Section 547(c)(1) provides that a transfer cannot be avoided "to the extent [it] was . . . intended by the debtor and the creditor to

1. Unsecured creditors may then share in any avoided payments on a pro rata basis.

or for whose benefit [it] was made to be a contemporaneous exchange for new value given to the debtor; and [it] in fact [was] a substantially contemporaneous exchange." 11 U.S.C.A. § 547(c)(1). The purpose of the § 547(c)(1) exception is "to encourage creditors to continue to deal with troubled debtors without fear that they will have to disgorge payments received for value given." *Collier on Bankruptcy* ¶ 547.04 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009). As its legislative history demonstrates, § 547(c)(1) was designed to address the "generic problem [that] those on the verge of bankruptcy still need to buy things . . . and the fact that checks are used (with a brief gap between purchase and payment) ought not render the payment avoidable as one made for an antecedent debt." *Collins v. Greater Atl. Mortgage Corp. (In re Lazarus)*, 478 F.3d 12, 18 (1st Cir. 2007) (citing H.R. Rep. No. 95-595, at 373 (1977)); *see Batlan v. TransAmerica Commercial Fin. Corp. (In re Smith's Home Furnishings, Inc.)*, 265 F.3d 959, 965 n.4 (9th Cir. 2001) (explaining that § 547(c)(1) "was designed to prevent trustees from avoiding payments that were clearly intended to support a new transaction, instead of an antecedent debt, even though the actual payment was not recorded until after the transaction"). Protecting contemporaneous exchanges for new value from avoidance does not harm the preference section's goal of protecting the equality of distribution among the debtors because such exchanges do not diminish the size of the debtor's estate. *See Jones Truck Lines, Inc. v. Cent. States, Se. & Sw. Areas Pension Fund (In re Jones Truck Lines)*, 130 F.3d 323, 326 (8th Cir. 1997).

Appendix A

The Trustee moved for partial summary judgment on the issue of whether the transfers satisfied the § 547(b) requirements, and United moved for summary judgment. The Trustee argued that it had established all of the § 547(b) elements as a matter of law. As is relevant here, United responded that the Trustee could not establish that the transfers were preferences under § 547(b) because the transferred funds were not property of the estate. United also argued that the Trustee could not satisfy § 547(b)(5) with regard to the transfers because United would have received full payment from the Surety by enforcing its bond rights had the Debtor not made the transfers.

United further contended that the § 547(c)(1) defense applied because the transfers had the effect of discharging United's right to file and enforce a mechanic's lien. United finally maintained that certain payments from the Debtor to United were in exchange for new value in the form of credit extended to the Debtor after the transferred funds were received.

Considering the parties' cross-motions, the bankruptcy court ruled as a matter of law that the Trustee met its burden of establishing that the transfers were preferences under § 547(b). Regarding United's argument that had the challenged transfers not been made, United still would have received full payment from the bond, the court reasoned that the critical question with regard to § 547(b)(5) was not whether the creditor would have received payment from *another source* had the challenged transfer not been made, but rather,

whether it would have received payment from the Chapter 7 bankruptcy estate. As for United's new-value defense, the bankruptcy court noted that the Trustee did not dispute United's assertion that some payments made to the Debtor were in exchange for credit that United extended to the Debtor after the transferred funds were received. The bankruptcy court thus ruled that United was "entitled to a minimum credit of $8885.66 based on new value, and it has the right to try to increase that amount upon an appropriate showing at trial." J.A. 179.

The case then proceeded to trial regarding United's § 547(c)(1) defense. United sought to prove that the transfers were substantially contemporaneous exchanges for new value because they extinguished United's rights to file and enforce a lien as well as its rights to obtain payment through the bond. The bankruptcy court found that the § 547(c)(1) defense was not established because the discharge of United's inchoate lien rights and bond rights did not constitute new value. The court noted that United had not perfected any lien or security interest in property to secure the Debtor's debt and thus had no interest to release in exchange for the transfers. The court ruled that to establish the § 547(c)(1) defense with regard to its inchoate lien and bond rights, United would have to prove that it would have timely enforced these rights and been paid in full had the challenged transfers not been made, and that at that time the Debtor was still owed funds by the general contractor on which the Surety could have asserted a lien. Concluding that

United failed to establish the former point, the court ruled that the Trustee was entitled to recover the remainder of the challenged transfers—$ 66,963.74—for the benefit of the bankruptcy estate. United then appealed to the district court, which affirmed the bankruptcy court judgment.

II.

United argues that the bankruptcy court erred in granting partial summary judgment against it regarding whether the transfers were preferences under § 547(b). We find no reversible error.

We review a grant of partial summary judgment by the bankruptcy court and the affirmance thereof by the district court de novo. *See Bank of N.Y. v. Treco (In re Treco)*, 240 F.3d 148, 155 (2d Cir. 2001). Summary judgment in bankruptcy is governed by Federal Rule of Bankruptcy Procedure 7056, which incorporates the standards of Federal Rule of Civil Procedure 56 into bankruptcy proceedings. *See* Fed. R. Bankr. P. 7056; Fed. R. Civ. P. 56. Thus, in reviewing a grant of partial summary judgment, we view the facts and the reasonable inferences drawn therefrom in the light most favorable to the nonmoving party. *See EEOC v. Navy Fed. Credit Union*, 424 F.3d 397, 405 (4th Cir. 2005). Partial summary judgment is appropriate "if there is no genuine issue of material fact and the moving party is entitled to a judgment as a matter of law." *Cline v. Wal Mart Stores, Inc.*, 144 F.3d 294, 300 (4th Cir. 1998).

Appendix A

Section 547(b) states:

> Except as provided in [11 U.S.C.A. § 547(c) and (i)], the trustee may avoid any interest of the debtor in property—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made—
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) *that enables such creditor to receive more than such creditor would receive if—*
>
> *(A) the case were a case under chapter 7 of this title;*
>
> *(B) the transfer had not been made; and*

> *(C) such creditor received payment of such debt to the extent provided by the provisions of this title.*

11 U.S.C.A. § 547(b) (emphasis added); *see Morrison v. Champion Credit Corp. (In re Barefoot)*, 952 F.2d 795, 798 (4th Cir. 1991). The bankruptcy trustee bears the burden of proving that a transfer is avoidable under § 547(b). *See* 11 U.S.C.A. § 547(g) (West 2004).

United contends that the bankruptcy court erred in concluding at the summary judgment stage that the Trustee had established the fifth § 547(b) requirement as a matter of law. This is so, United argues, because had the transfers not been made, United could have received full payment from the Surety by enforcing its bond rights.[2] The bankruptcy court properly rejected this argument, however. The § 547(b)(5) inquiry focuses "not on whether a creditor may have recovered all of the monies owed by the debtor *from any source whatsoever*, but instead upon whether the creditor would have received less than a 100% payout" from the

2. United similarly argues that the court's resolution of the § 547(b) issue at the summary judgment stage was improper because the Trustee failed to show as a matter of law that, had the transfers not been made, United would not have obtained full payment from the hypothetical Chapter 7 estate by enforcing its lien rights and thereby attaining secured-creditor status. Because this argument is raised for the first time on appeal, we do not address it. *See Williams v. Prof'l Transp. Inc.*, 294 F.3d 607, 614 (4th Cir. 2002) ("Issues raised for the first time on appeal are generally not considered absent exceptional circumstances.").

bankruptcy estate. *Smith v. Creative-Financial Mgmt., Inc., (In re Virginia-Carolina Fin. Corp.)*, 954 F.2d 193, 199 (4th Cir. 1992).

III.

United next argues that the district court erred in finding that it did not establish a § 547(c)(1) defense at trial.[3] We disagree.

A.

We review the district court decision de novo, "effectively standing in its shoes to consider directly the findings of fact and conclusions of law by the bankruptcy court." *Cypher Chiropractic Ctr. v. Runski (In re Runski)*, 102 F.3d 744, 745 (4th Cir. 1996). "[W]e review legal conclusions by the bankruptcy court de novo and may overturn its factual determinations only upon a showing of clear error." *Id.*

The party against whom recovery or avoidance is sought bears the burden of proving a § 547(c) defense. *See* 11 U.S.C.A. § 547(g). As we have explained, § 547(c)(1) prevents a bankruptcy trustee from avoiding a transfer "to the extent [it] was . . . intended by the debtor and the creditor to or for whose benefit [it] was

3. United also argues that it established a defense under 11 U.S.C.A. § 547(c)(6). Because this argument is raised for the first time on appeal, we do not consider it. *See Williams*, 294 F.3d at 614.

made to be a contemporaneous exchange for new value given to the debtor; and [it] in fact [was] a substantially contemporaneous exchange." 11 U.S.C.A. § 547(c)(1). The Bankruptcy Code defines "new value" to mean

> money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property.

11 U.S.C.A. § 547(a)(2) (West 2004). "New value," however, "does not include an obligation substituted for an existing obligation." *Id.*

B.

United argues that it established a § 547(c)(1) defense under the "indirect transfer theory." In this regard, United first contends that had the Debtor not made the transfers, United nonetheless could have obtained full payment by enforcing its bond rights. United maintains that had the Surety paid such a claim under the bond, the Surety would have automatically received an equitable lien by subrogation against the funds the general contractor owed the Debtor. Relying on *O'Rourke v. Seaboard Surety Co. (In re E.R. Fegert, Inc.)*, 887 F.2d 955 (9th Cir. 1989) ("*Fegert*"), United argues that the money that the Debtor was eventually paid (that the Surety could have obtained directly from

the general contractor had United enforced its bond rights) constituted new value to the Debtor for purposes of § 547(c)(1).

In *Fegert*, a general contractor ("the debtor") defaulted on its payments to two subcontractors. *See Fegert*, 887 F.2d at 956. The subcontractors, in turn, sued the debtor and the surety that had issued a payment and performance bond on the debtor's behalf. *See Fegert*, 887 F.2d at 956. Prior to trial, the debtor and the surety made payments to the subcontractors that, when combined, satisfied the debt and resulted in dismissal of the suit. *See id.* Within 90 days of these payments, the debtor filed a Chapter 11 bankruptcy petition that was later converted to a Chapter 7 proceeding. *See id.* In a subsequent adversary proceeding, the bankruptcy trustee sought to avoid the payments from the debtor as preferential. *See id.* The bankruptcy court granted summary judgment against the trustee, and the Bankruptcy Appellate Panel and the Ninth Circuit affirmed. *See id.* at 956-57. The Ninth Circuit reasoned that if the debtor had not paid the debt in full, the subcontractors would have been paid by the surety, which then would have had an equitable lien against the funds owed the debtor by the owner. *See id.* at 958-59. The court noted that "[t]wo circuits have held that payments by a debtor in exchange for a secured creditor's release of its security interest falls within the exception of section 547(c)(1)." *Id.* at 959 (citing *Gulf Oil Corp. v. Fuel Oil Supply & Terminaling, Inc. (In re Fuel Oil Supply & Terminaling, Inc.)*, 837 F.2d 224, 229-30 (5th Cir. 1988), and *Kenan v. Fort Worth Pipe*

Co. (In re George Rodman, Inc.), 792 F.2d 125, 127 (10th Cir. 1986)). The court therefore held that "[t]he security interest constitutes the 'new value' that is 'contemporaneously exchanged'" and noted that "the value of the debtor's estate is not diminished." *Id.*

Without deciding the correctness of the *Fegert* court's conclusion that the release of the surety's security interest in that case constituted "new value" contemporaneously received by the debtor, we conclude that that was not the case on the facts before us. Since United never even attempted to make any claim on the bond here, the Surety never obtained any lien that it could release. It is therefore not surprising that United does not even argue to us that the Debtor received new value by virtue of the removal of the possibility that any such lien would ever be created.

What United does argue is that new value was given to the Debtor in the form of the *money* that it eventually received from the general contractors that might have instead been paid to the Surety had the Surety paid a bond claim. This argument does not work. Even if the money the Debtor paid to United in the transfers was eventually offset by the Debtor's later receipt of funds that the Surety might otherwise have claimed, United has not shown when the Debtor received this "new value." Accordingly, regardless of whether the transfers set in motion a chain of events that resulted in the Debtor's recoupment of the amounts paid, United did not show that such new value was "'given to the debtor' . . . as part of a 'contemporaneous exchange.'"

Appendix A

Baker Hughes Oilfield Operations, Inc. v. Cage (In re Ramba, Inc.), 416 F.3d 394, 399-400 (5th Cir. 2005) ("[I]t is the precise benefit received . . ., and not the secondary or tertiary effects thereof, that must fit within one of the five categories of 'new value' . . . enumerated in § 547(a)(2)."). In this case, the only benefit that United showed the Debtor was given as part of the contemporaneous exchange for the transfers was the extinguishment of its debt, which does not fit within any of the five new-value categories.

Furthermore, even assuming *arguendo* that the transfers were part of a contemporaneous exchange for new value, United produced no evidence that the Debtor and United *intended* that would be the case. United failed to produce evidence that the parties viewed this transaction as anything more than the payment of the debt of an as-yet unsecured creditor; no evidence demonstrated when the parties believed the Debtor might recoup some of the transferred funds or even that they believed any funds would be recouped.

C.

Similar to its argument that it could have pursued payment from the Surety, United contends that had the transfers not been made, it also could have pursued its right to file a North Carolina mechanic's lien on the real property improved by one of the construction projects. To the extent that United maintains that the new value given to the Debtor was money—the money it retained by not having to face offset claims that the property

owner would have gained from United's enforcement of its lien rights—the argument fails for the same reasons we have discussed regarding its bond argument. United argues, however, that the discharge of United's inchoate lien rights themselves constitutes new value, independent of any financial benefit the Debtor received from the discharge. In particular, United claims that it held a security interest in the owners' properties at the time of the transfers (and thus "had property previously transferred," 11 U.S.C.A. § 547(a)(2)) because the mechanic's lien statutes immediately grant a security interest to a supplier who furnishes labor or material to improve the property. The Code's definition of "transfer" indeed includes "the creation of a lien." 11 U.S.C. § 101(54)(A) (West Supp. 2009). However, just as the Surety did not have an equitable lien to release since it had not paid a claim on the bond, United did not have a security interest to release because it never filed the mechanic's lien claim necessary to obtain such an interest.

Under North Carolina law, a person who improves real property, including by providing rental equipment pursuant to a contract with the owner, "shall, upon complying with the provisions of this Article, have a right to file a claim of lien on real property [also known as a mechanic's lien] on the real property to secure payment of all debts owing for" rented equipment. N.C. Gen. Stat. § 44A-8 (2009); *see also* N.C. Gen. Stat. § 44A-12 (2009) (providing the place, time, and contents of the filing required for a mechanic's lien). Such a lien "shall relate to and take effect from the time of the first furnishing

of labor or materials at the site of the improvement by the person claiming the claim of lien on real property." N.C. Gen. Stat. § 44A-10 (2009).

A first-, second-, or third-tier subcontractor who has furnished rental equipment in the improvement of real property, upon compliance with certain requirements, may also enforce the contractor's lien on real property. *See* N.C. Gen. Stat. § 44A-23 (2009). Once a subcontractor has filed a lien, it may enforce the lien within 180 days after the last furnishing of labor or materials to the real property by filing a lawsuit. *See* N.C. Gen. Stat. § 44A-13 (2009). A mechanic's lien is discharged by failure to enforce the claim of lien within the prescribed time. *See* N.C. Gen. Stat. § 44A-16(3) (2009).

As we have explained, United claims that it held a security interest in the owners' properties at the time of the transfers because the mechanic's lien statutes immediately grant a security interest to a supplier who furnishes labor or material to improve the property. United bases this argument on the notion that a mechanic's lien, once filed, is retroactively effective to the time the material or labor were furnished. United's conclusion does not follow from its premise, however. North Carolina's mechanic's lien statutes grant a supplier of labor or material only *the right to file a mechanic's lien*, which United did not do here. *See* N.C. Gen. Stat. § 44A-8 ("Any person who . . . furnishes rental equipment . . . shall, upon complying with the provisions of this Article, have *a right to file a claim of lien* on real property." (emphasis added)). Only upon the filing of a

claim for a mechanic's lien is the owner's property encumbered. *See* N.C. Gen. Stat. § 44A-10 ("*A claim of lien* on real property granted by this Article shall relate to and take effect from the time of the first furnishing of labor or materials at the site of the improvement by the person claiming the claim of lien on real property" (emphasis added)). Because United had not filed such a claim when the transfers were made, no interest had been transferred to United and United had no such interest to release.[4]

United argues that it would not make sense from a policy standpoint to force a subcontractor in United's position to refuse tendered payments and file a mechanic's lien. But it does not necessarily follow from our holding that subcontractors would need to take that course. Indeed, United argues in this very appeal that the Trustee, in order to prove that the transfers were even preferences under § 547(b), should have been required to show that had the transfers not been made, United would not have promptly filed lien claims and thereby attained secured creditor status such that it could have obtained full payment in a hypothetical Chapter 7 bankruptcy. Whether United's argument is correct is an issue that will have to wait for another case in which the issue is properly preserved. *See supra*, at 7 n.2 (explaining that we do not address this argument because United raised it for the first time on appeal).

4. United argues that *McCoy v. Wood*, 70 N.C. 125 (1874), is to the contrary. However, as United concedes, *McCoy* did not interpret the mechanic's lien statutes at issue here. Indeed, the mechanic's lien statutes considered in *McCoy* did not have comparable wording to those before us now.

Appendix A

Our holding today is limited to the conclusion that United did not establish the § 547(c)(1) defense beyond the amounts determined by the bankruptcy court at the summary judgment stage. This holding makes perfect sense when viewed in the context of § 547(c)(1)'s purpose, to accommodate the need of financially unsteady companies to use checks to pay for new transactions. *See In re Lazarus*, 478 F.3d at 18; *In re Smith's Home Furnishings, Inc.*, 265 F.3d at 965 n.4. The facts of this case, wherein the transfers were not made substantially contemporaneously with United's supplying of the equipment and parts that generated the debt, present a completely different scenario.

IV.

For the foregoing reasons, we affirm the district court order affirming the bankruptcy court judgment in favor of the Trustee.

AFFIRMED

APPENDIX B — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA, SOUTHERN DIVISION DATED JANUARY 22, 2009

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF
NORTH CAROLINA
SOUTHERN DIVISION

No. 7:08-CV-97-BO

UNITED RENTALS, INC.,

Appellant,

v.

JAMES B. ANGELL, Chapter 7 trustee for Partitions Plus of Wilmington, Inc. D/B/A Partitions, Inc., D/B/A Storm Protections Systems,

Appellee.

ORDER

This matter is before the Court on United Rentals, Inc.'s ("Appellant") appeal from Bankruptcy Court. The issues on appeal are: (1) whether the Bankruptcy Court properly granted summary judgment for Appellee for Appellee's 11 U.S.C. § 547(b) claims; and (2) whether the Bankruptcy Court properly granted judgment for Appellee in finding that transfers to the Appellant were only subject to the new value defense under 11 U.S.C.

§ 541(c)(1) in the amount of $8,885.66. For the reasons stated below, the Bankruptcy Court's decision is AFFIRMED.

I. *SUMMARY OF THE INSTANT DISPUTE*

Partitions Plus of Wilmington, Inc. ("Partitions Plus") filed a Chapter 11 bankruptcy petition on September 1, 2004. On November 9, 2004, the case was converted to a Chapter 7 bankruptcy proceeding and James B. Angell ("Appellee") was appointed trustee for Partitions Plus. On July 14, 2006, Trustee filed a complaint, alleging that Partitions Plus made preferential transfers to Appellant in the amount of $75,849.40 and that these transfers were avoidable pursuant to 11 U.S.C. § 547(b) and recoverable under 11 U.S.C. § 550(a).

The Bankruptcy Court produced three separate orders in this case: one on June 14, 2007, one on March 31, 2008, and one on April 30, 2008. In the first order, the Bankruptcy Court held that Appellee had established that the payments in question constituted preferential payments and that Appellant was entitled to a minimum credit of $8,885.66 based on its new value defense. The actual amount of the credit was to be determined at another date. In the second order, the Bankruptcy Court held that Appellee was entitled to recover $66,963.74 in preferential payments from Appellant, effectively ruling on the amount of credit Appellant received. This order did not mention prejudgment interest.

Appendix B

In the third order, the Bankruptcy Court ruled that Angell was entitled to recover prejudgment interest at the rate of 4.89% per annum from May 16, 2006, until April 30, 2008, and denied Appellant's motions to stay. On May 9, 2008, Appellant appealed from this decision. This appeal is now ripe for ruling.

II. *DISCUSSION*

The District Court has jurisdiction to hear appeals from final judgments, orders, and decrees entered in cases and proceedings of the Bankruptcy Court. 28 U.S.C. § 158(a)(1) (2008). An appeal from the Bankruptcy Court shall be taken by the District Court if filed within the time allowed by Fed. R. Bankr. P. 8002. On appeal from a final decision of a Bankruptcy Court, the District Court acts as an appellate tribunal, reviewing findings of fact for clear error and conclusions of law *de novo*. *Butler v. David Shaw, Inc.*, 72 F.3d 437, 440 (4th Cir. 1996).

Under 11 U.S.C. § 547(b), a trustee may avoid any transfer of the debtor's interest in property if the transfers: (1) were to or for the benefit of a creditor; (2) were for or on account of antecedent debts; (3) were made while the debtor was insolvent; (4) were made on or within ninety (90) days before the debtor field bankruptcy; and (5) enabled the defendant to receive more than he would have received if the transfers had not been made. The trustee has the burden of proving the avoidability of the transfer(s). 11 U.S.C. § 547(g).

A preferential transfer may not be avoided, however, "to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—(A) not secured by an otherwise unavoidable security interest; and (B) on account of which new value of the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor." 11 U.S.C. § 547(c)(4).

Appellant does not contest that the first four elements of a preferential transfer are met. Thus, the issues before the Court are: (1) what portion, if any, Partitions Plus had interest in; (2) whether the transfers enabled Appellant to receive more than it would have if the transfers had not been made; and (3) whether Appellant gave new value to Partitions Plus after a transfer was made. Each of these issues is addressed below.

A. Partitions Plus had interest in all of the transferred property.

Appellant argued that: (1) the General Agreement of Indemnity ("GAI") entered into between US Fire and Partitions Plus created an express trust, which meant that the monies paid to Appellant were not the property of Partitions Plus; and (2) Appellant had an equitable lien in the transferred funds received from Partitions Plus on account of equipment supplied by Appellant on construction projects.

First, no express trust was created because the trust fund assets were commingled with non-trust assets, which "by itself is fatal" to the claim of an express trust. *Harleysville Worcester Mutual Ins. Co. v. Fleet Nat'l Bank (In re Suprema Specialties, Inc.)*, 2007 U.S. Dist. LEXIS 33937, at *35 (S.D.N.Y. May 7, 2007) (citing *Agudas Chasidei Chabad v. Gouray*, 833 F.2d 431 (2d Cir. 1987).[1]

Second, Appellant incorrectly bases its argument that it had an equitable lien in the transferred funds on the expansion of the Supreme Court's analysis of a surety's subrogation rights in *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132 (1962),[2] to an unpaid subcontractor's rights. However, as noted by the Bankruptcy Court, such analysis was rejected by the Fourth Circuit in *Grochal v. Ocean Technical Servs. Corp. (In re Baltimore Marine Indus.)*, 476 F.3d 238, 241-42 (4th Cir. 2007) (holding that surety who has fully paid all subcontractors has a greater right to retained funds than that of an unpaid subcontractor).

Thus, Partitions Plus had an interest in all of the transferred property.

1. Note that the parties had a choice of law provision in which they agreed that New York law would be applied.

2. A "surety, having paid the laborers and materialmen, is entitled to the benefit of all these rights to the extent necessary to reimburse it." *Pearlman*, 371 U.S. at 141.

B. Appellant received more than it would have if the transfers had not occurred.

Appellant's claim that it would have received payment in full by filing a claim against Partitions Plus is contradicted by the evidence. "[T]he court must focus, not on whether a creditor may have recovered all of the monies owed by the debtor from any source whatsoever, but instead upon whether the creditor would have received less than a 100% payout in Chapter 7 liquidation." *Smith v. Creative Financial Mgmt, Inc. (In re Virginia-Carolina Fin. Corp.)*, 954 F.2d 193, 199 (4th Cir. 1992). Appellee submitted affidavits which proved that there were inadequate funds to provide a payout in full to unsecured creditors. Appellant, as an unsecured creditor,[3] would not have received payment in full had the debtor not provided it. Thus, Appellant received more than it would have if the transfers had not been made.

C. The Bankruptcy Court appropriately determined the extent to which Appellant could recover under the new value defense.

While it is undisputed that Appellant is entitled to some credit against the amount of preferential payments for subsequent advances of new value pursuant to 11 U.S.C. § 547(c)(4), the Bankruptcy Court correctly

3. Appellant is an unsecured creditor because it failed to file notice. *See* N.C. Gen. Stat. § 44A-18(6); *see also Precision Walls v Crampton (In re Precision Walls)*, 196 B.R. 299 (E.D.N.C. 1996).

restricted this amount to the uncontested amount of credit Appellant extended to Partitions Plus. Appellant, as the creditor or party in interest against whom recovery or avoidance is sought, has the burden of proving the non-avoidability of the transfer. 11 U.S.C. § 547(g). "New value" includes "money or money's worth in goods, services, or new credit." 11 U.S.C. § 547(a)(2). In order to prevail on a new value defense using an "indirect transfer" theory in a case involving a subcontractor's release of a potential bond claim, the creditor must show: (1) that it would have timely filed a claim against the project's payment bond and been paid in full had it not received payment from the debtor; and (2) that, at the time, the debtor was still owed funds by the general contractor on which the bonding company would have asserted a lien. *Angell v. Pennington et al.*, Adv. Pro. 06-00148-8-AP, at *5-6 (Bankr. E.D.N.C. March 20, 2008).

Appellant presented no evidence to the Bankruptcy Court that it would have filed a claim and been paid in full had it not received payment from Appellee. Appellant admits that it had not filed a claim against Appellee prior to Appellee filing suit, despite the fact that Appellee owed it money at the time Appellee initially filed suit. Appellant further failed to produce any evidence of its practice of filing claims. Even if Appellant had filed a claim, Partitions Plus would not have been capable of paying it in full because, as noted above, it did not have the finances to fully pay off the unsecured creditors. Therefore, the Bankruptcy Court correctly determined that Appellant established its new value defense only to the extent of the uncontested amount of credit: $8,885.66.

III. *CONCLUSION*

This Court AFFIRMS the Bankruptcy Court's decision that Appellee satisfied its burden of establishing that preferential payments were made to Appellant and that Appellant only established its new value defense to the extent of the uncontested amount of credit.

SO ORDERED, this 22 day of January 2009.

s/ Terrence W. Boyle
TERRENCE W. BOYLE
UNITED STATES DISTRICT JUDGE

APPENDIX C — AMENDED JUDGMENT ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA, WILMINGTON DIVISION DATED APRIL 30, 2008

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF
NORTH CAROLINA
WILMINGTON DIVISION

Case No. 04-06776-8-JRL
Chapter 7

Adversary Proceeding
No. 06-00152-8-AP

IN RE:

PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Debtor.

JAMES B. ANGELL, CHAPTER 7 TRUSTEE FOR PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Plaintiff,

v.

UNITED RENTALS, INC.,

Defendant.

Appendix C

ORDER

This case is before the court on a motion by James B. Angell, chapter 7 trustee for Partitions Plus of Wilmington, Inc., to alter or amend the judgment to include an award of prejudgment interest, and two motions by United Rentals, Inc.: the first to stay the judgment pending disposition of the trustee's motion to alter or amend the judgment, and the second to stay the judgment pending appeal.

I. Trustee's Motion to Alter or Amend Judgment

After conducting a trial in this adversary proceeding, the court entered an order on March 31, 2008, finding that the trustee was entitled to recover $66,963.74 in preferential payments from United Rentals. The clerk entered judgment accordingly. On April 4, 2008, the trustee filed a motion pursuant to Fed. R. Bankr. P. 9023 and Fed. R. Civ. P. 59(e) to alter or amend the judgment to include an award of prejudgment interest. The trustee's motion argues that prejudgment interest is appropriate from the date of demand of the return of the preference. In opposition to the trustee's motion, United Rentals argues that (1) there are no grounds to justify amending the judgment, (2) prejudgment interest is inappropriate where the amount the estate is entitled to recover is not determined until trial, and (3) the trustee presented no evidence to substantiate a claim for prejudgment interest.

Appendix C

"It is well settled that bankruptcy courts have discretion to award prejudgment interest in § 547 preferential transfers actions, and to compute that interest from the date of demand for the return of the transferred funds. *Sigmon v. Royal Cake Co. (In re Cybermech, Inc.)*, 13 F3d 818, 822 (4th Cir. 1994). A prejudgment interest award "serves to 'compensate the debtor's estate for [the defendant's] use of those funds that were wrongfully withheld from the debtor's estate during the pendency of the [litigation].'" *Id.* (quoting *In re Investment Bankers, Inc.*, 4 F3d 1556, 1566 (10th Cir. 1993)).

United Rentals first argues that the court's order implicitly denied prejudgment interest, and that the trustee's mere disagreement with the denial of prejudgment interest does not present one of the three circumstances identified by the Fourth Circuit as justifying Rule 59(e) relief. Although United Rentals reads the court's order as denying an award of prejudgment interest, omission of that issue was purely a matter of inadvertence rather than deliberate consideration. Therefore, the trustee does not seek reconsideration of that issue, but rather presents the issue for resolution in the first instance.

United Rentals's argument proceeds on the theory that the trustee does not present an issue that justifies relief under Rule 59(e). Although the authority cited by United Rentals suggests that there are three grounds for amending an earlier judgment pursuant to Rule 59(e), *see Pacific Ins. Co. v. American Nat. Fire Ins.*

Co., 148 F.3d 396, 403 (4th Cir. 1998), nothing in that precedent suggests that there are *only* three grounds for relief under Rule 59(e). In fact, the Supreme Court has specifically found that a postjudgment motion for discretionary prejudgment interest clearly falls under Rule 59(e). *Osterneck v. Ernst & Whinney*, 489 U.S. 169 (1989). Further, "if the district court's original judgment did not mention an award of prejudgment and postjudgment interest, [a postjudgment motion for discretionary prejudgment interest] clearly would be governed by *Osterneck* . . . ." *Kosnoski v. Howley*, 33 F.3d 376, 378 (4th Cir. 1994). Because the March 31, 2008 order did not address the issue of prejudgment interest, the trustee's motion sets forth a cognizable basis for relief under Rule 59(e).

United Rentals's second argument is that the trustee is not entitled to prejudgment interest because the amount of damages was undetermined until judgment. Citing precedent approving this principle, United Rentals argues that damages were undetermined in this case because its liability could have been reduced or completely eliminated by its new value defense. United Rentals cites several cases in support of this proposition, including *In re Investment Bankers, Inc.*, 4 F.3d 1556, 1566 (10th Cir. 1993), and *In re Bellanca Aircraft, Corp.*, 850 F.2d 1275, 1281 (8th Cir. 1988). However, the precedent relied on by these cases is more concerned with a party's inability to calculate damages with a mathematical certainty at the outset of the case, such as in personal injury and wrongful death actions, rather than the possibility that a damage claim

for a specified amount may be reduced by an affirmative defense. Accepting United Rentals's argument would effectively eliminate the possibility of a prejudgment interest award in preference actions involving an affirmative defense. The trustee's complaint requested a specific damage figure, and the possibility that United Rentals could have offset that amount by establishing a new value defense does not prevent an award of prejudgment interest. *See Precision Walls v. Crampton*, 196 B.R. 299 (E.D.N.C. 1996) (affirming prejudgment interest award in a preference action where trustee received less than amount sought in complaint).

United Rentals's final argument is that the trustee is not entitled to prejudgment interest because he produced no evidence of the basis for, or the amount of, a prejudgment interest claim. The fundamental flaw with this argument is that no evidence was necessary because the parties agreed to the only disputable element of the trustee's claim for prejudgment interest. The issue of liability aside, the only elements necessary to determine a proper award of prejudgment interest are (1) the interest rate, and (2) the date on which the interest runs. Of these two elements, only the date on which the interest begins to run may be seriously disputed.[1] A trustee is "entitled . . . to prejudgment interest from the date of demand for its return, or in the absence of a

1. The prejudgment interest rate in a preference action is set by 28 U.S.C. § 1961, unless a trial judge finds that the equities require a different rate – a finding the court declines to make in this case. *See Banks v. Gill Distrib. Ctr., Inc.*, 263 F.3d 862, 871 (9th Cir. 2001).

prior demand, from the date of filing of the complaint." *Id.* at 305 (E.D.N.C. 1996); *In re H.P. King, Co.*, 64 B.R. 487, 489 (Bankr. E.D.N.C. 1986). The parties stipulated in the final pre-trial report, incorporated by the Final Pre-Trial Order entered by the court, that the demand letter requesting return of the transfers was sent on May 16, 2006. Accordingly, the trustee is entitled to recover prejudgment interest at the rate of 4.98% per annum, which represents the one-year constant maturity Treasury yield on the date of demand, from May 16, 2006, until the date of the amended judgment accompanying this order.[2]

II. United Rentals's Motion to Stay Pending Appeal

In considering United Rentals's motion to stay the judgment pending appeal, the court is guided by four factors: (1) the likelihood of success on the merits; (2) the likelihood of irreparable harm; (3) harm to others; and (4) whether the public interest will be served. Based on these factors, the court declines to stay the judgment pending appeal. *See e.g., Mich. Coalition of Radioactive Material Users v. Griepentrog*, 945 F.2d 150, 153 (6th Cir. 1991). First, United Rentals has failed to demonstrate that it is likely to succeed on appeal. United Rentals does not identify, either in its motion or in its supporting memorandum, any errors made by the court.

2. Because the court has ruled on the trustee's motion to alter or amend the judgment, the court denies as moot United Rentals's motion to stay the judgment pending disposition of the trustee's motion.

However, even looking to its designation of issues for appeal, the court carefully considered each issue and is not satisfied that United Rentals is likely to succeed in its appeal. Second, there is little likelihood that United Rentals will be harmed by the judgment. As its memorandum supporting its motion concedes, United Rentals is a $4 billion company, and it is not likely that it will be harmed by enforcement of the judgment prior to appeal. Third, the trustee is harmed by staying the judgment because it cannot adequately develop an orderly plan of distribution of the debtor's estate without the funds owed. Finally, having already determined that United Rentals is not likely to succeed on appeal, the public interest is better served by the expedient administration of the debtor's estate. *See e.g.*, *In re Metiom, Inc.*, 318 B.R. 263, 272 (S.D.N.Y. 2004).

CONCLUSION

The trustee's motion to alter or amend the judgment is granted. The clerk is directed to enter an amended judgment to reflect an award of prejudgment interest in favor of the trustee from May 16, 2006, until the date of the amended judgment entered pursuant to this order, at an interest of 4.98% per annum, and thereafter at the current judgment rate. United Rentals's motion to stay pending disposition of the trustee's motion to alter or amend the judgment is denied as moot, and its motion to stay pending appeal is also denied.

"END OF DOCUMENT"

APPENDIX D — JUDGMENT ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA, WILMINGTON DIVISION DATED MARCH 31, 2008

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF
NORTH CAROLINA
WILMINGTON DIVISION

Case No. 04-06776-8-JRL
Chapter 7

Adversary Proceeding
No. 06-00152-8-AP

IN RE:

PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Debtor.

JAMES B. ANGELL, CHAPTER 7 TRUSTEE FOR PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Plaintiff,

v.

UNITED RENTALS, INC.,

Defendant.

Appendix D

ORDER

This case is before the court on the complaint of James B. Angell, chapter 7 trustee for Partitions Plus of Wilmington, Inc., against defendant United Rentals, Inc., to avoid certain preferential transfers and to recover such transfers for the benefit of the estate. On February 28, 2008, a trial was held in Raleigh, North Carolina.

FACTS AND BACKGROUND

Partitions Plus of Wilmington, Inc. filed a chapter 11 bankruptcy petition on September 1, 2004. On November 9, 2004, the case was converted to one under chapter 7, and James B. Angell was appointed the trustee. Prior to the debtor filing bankruptcy, United Rentals supplied rental equipment to the debtor for use on certain construction projects.

On July 14, 2006, the trustee filed this adversary proceeding. The complaint alleges that Partitions Plus made preferential transfers to United Rentals in the amount of $75,849.40, and that these transfers are avoidable pursuant to 11 U.S.C. § 547(b) and recoverable under § 550(a). Both parties filed motions for summary judgment. By order dated June 4, 2007, the court concluded that the trustee established that the payments in question constituted preferential payments. The court also concluded that United Rentals was entitled to a minimum credit of $8,885.66 based on its new value defense, and that it could increase that

amount upon an appropriate showing at trial. Therefore, the sole remaining issue is the extent of United Rentals's new value defense.

ANALYSIS

United Rentals argues that the contemporaneous exchange for new value in this case was the discharge of lien rights, bond rights, and a security interest in exchange for the preferential payments. It contends that it is irrelevant whether it would have perfected its security interests or enforced its lien and bond rights.[1] However, as the court noted in *Angell v. Pennington et al.*, Adv. Pro. 06-00148-8-AP (Bankr. E.D.N.C. March 20, 2008), the problem with presuming that the existence of inchoate rights is equivalent new value to the preferential transfer is that it effectively relieves United Rentals of its burden under 11 U.S.C. § 547(g) of establishing the actual value of the transfer. Under its theory, it would be nearly impossible for a trustee ever to maintain a preference suit against a subcontractor who possessed any sort of inchoate or hypothetical lien or bond claims.

1. United Rentals argues that it possessed lien rights and a security interest on property of the debtor. However, United Rentals presented no evidence that it ever perfected the lien. Pursuant to *Precision Walls, Inc. v Crampton*, 196 B.R. 299 (E.D.N.C. 1996), however, United Rentals was an unsecured creditor since it never perfected its lien. Therefore, it possessed no security interest or lien claim that could be extinguished in exchange for the preferential payment.

Appendix D

In *Pennington*, this court set forth the elements of a new value defense using an "indirect transfer" theory in a case involving a subcontractor's release of a potential bond claim. A defendant must show that (1) it would have timely filed a claim against the project's payment bond and been paid in full had it not received payment from the debtor, and (2) at the time, the debtor was still owed funds by the general contractor on which the bonding company could have asserted a lien. *Id.* at 5-6. In establishing the first element, a subcontractor must present more than a mere modicum of evidence to support its contentions. *Id.* at 7-8. For example, the defendant in *Pennington* presented sufficient evidence in the form of convincing testimony that he would have filed a bond claim, his stated policy of addressing all overdue invoices in a manner that protected his ability to file a bond or lien claim, and the fact that he filed a bond claim and was paid in full in the only other instance of nonpayment. *Id.*

In this case, however, there is no similarly corroborative evidence that United Rentals would have filed a bond claim and been paid in full had it not received the preferential payment. In fact, the only evidence that United Rentals presented at trial related to the second prong of the test, i.e., whether there were sufficient funds owing to the debtor general contractor on which the bonding company could have asserted a lien. Despite United Rentals's argument that the court can presume that the existence of potential bond and lien claims is sufficient to establish equivalent new value, *Pennington* dictates otherwise, and the failure to

produce any evidence that it would have filed a bond claim and been paid in full is fatal to United Rentals's new value defense.

CONCLUSION

Accordingly, United Rentals has successfully established a new value defense with respect to $8,885.66 of the preferential payments. Therefore, the trustee is entitled to recover $66,963.74 of the preferential payments for the benefit of the estate. The clerk is directed to enter judgment accordingly.

"END OF DOCUMENT"

APPENDIX E — JUDGMENT ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA, WILMINGTON DIVISION DATED JUNE 14, 2007

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF
NORTH CAROLINA
WILMINGTON DIVISION

Case No. 04-06776-8-JRL
Chapter 7

Adversary Proceeding
No. 06-00152-8-AP

IN RE:

PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Debtor.

JAMES B. ANGELL, CHAPTER 7 TRUSTEE FOR PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Plaintiff,

v.

UNITED RENTALS, INC.,

Defendant.

Appendix E

ORDER

This case is before the court on a motion for summary judgment filed by United Rentals and a motion for summary judgment filed by the trustee. On June 4, 2007, the court conducted a hearing on these matters in Raleigh, North Carolina.

JURISDICTION AND PROCEDURE

This court has jurisdiction over the parties and the subject matter of this proceeding pursuant to 28 U.S.C. §§ 151, 157, and 1334, and the General Order of Reference entered by the United States District Court for the Eastern District of North Carolina on August 3, 1984. This is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2), which this court may hear and determine.

FACTS AND BACKGROUND

Partitions Plus of Wilmington, Inc. filed a chapter 11 bankruptcy petition on September 1, 2004. Thereafter, on November 9, 2004, the case was converted to one under chapter 7 and James B. Angell was appointed the trustee. Prior to the debtor filing bankruptcy, United Rentals supplied rental equipment to the debtor for use on certain construction projects.

On July 14, 2006, the plaintiff filed this adversary proceeding. The complaint alleged that the debtor made payments to the defendant within the ninety days prior

the debtor's bankruptcy filing. The plaintiff contends that those payments were preferential transfers and are avoidable pursuant to 11 U.S.C. § 547(b) and recoverable under 11 U.S.C. § 550(a) in the amount of $75,849.40.

STANDARD OF REVIEW

Under Federal Rule of Civil Procedure 56(c), made applicable in bankruptcy by Bankruptcy Rule 7056, summary judgment is proper "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." The "plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S. Ct. 2548, 2552 (1986). In making this determination, conflicts are resolved by viewing all facts and all reasonable inferences in the light most favorable to the nonmoving party. *United States v. Diebold, Inc.*, 369 U.S. 654, 655, 82 S. Ct. 993, 994 (1962).

Appendix I

ANALYSIS

A. 11 U.S.C. § 547(b)

Pursuant to 11 U.S.C. § 547(b) the trustee may recover certain preferential transfers made by the debtor in favor of specific creditors. In order for the trustee to avoid the transfers made by the debtor to the defendant, he must show that the transfers (1) were to or for the benefit of the defendant; (2) were for or on account of antecedent debts; (3) were made while the debtor was insolvent; (4) were made on or within ninety days before the debtor filed bankruptcy; and (5) enabled the defendant to receive more than he would have received if the transfers had not been made. 11 U.S.C. § 547(b). The Code places the burden on the trustee to prove the avoidability of the transfers. 11 U.S.C. § 547(g).[1] The burden of proving the nonavoidability of the transfers is placed on the creditor against whom avoidance is sought. *Id.*

It is not contested that the trustee has established the first four elements of a preferential transfer under § 547(b). The defendant received at least $75,849.40 from the debtor within ninety days of the petition date. At the time of each transfer, the debtor was insolvent, the defendant was a creditor of the debtor, and the transfers were made to or for the benefit of the defendant. The

1. As to the third element, there is a presumption that the debtor was insolvent during the ninety days prior to the petition date. 11 U.S.C. § 547(f).

only contested element relates to whether the defendant received more than he would have received if the case was under chapter 7, the transfers had not taken place, and the creditor received payment of such debt to the extent provided by the Code. 11 U.S.C. § 547(b)(5).

1. Express Trust

The defendant contends that the trustee cannot meet his burden under § 547(b(5) of the Bankruptcy Code, because the monies paid to the defendant from the debtor were not property of the debtor. In support of this position, the defendant asserts that under the General Agreement of Indemnity ("Indemnity Agreement") entered into between the debtor and US Fire any monies due the debtor on any bonded contracts were to be held in trust for the benefit of the defendant.[2]

The Indemnity Agreement provided that, "[t]his Instrument shall be governed by, construed and

> 2. Where any Bond is executed in connection with a contract, the Indemnitors covenant and agree to hold all money or proceeds of such contract, whether received as payment or as loans, as a trust for the benefit of laborers, materialman, suppliers, subcontractors and the Surety to use such money or other proceeds for the purpose of performing the contract and discharging the obligation of the Bond beneficiaries, and for no other purpose . . .[.]
>
> *US Fire Aff.*, General Agreement of Indemnity.

enforced in accordance with the laws of the State of New York without regard to its principles of conflicts of laws." North Carolina recognizes that "where parties to a contract have agreed that a given jurisdiction's substantive law shall govern the interpretation of the contract, such a contractual provision will be given effect." *Tanglewood Land Co., Inc. v. Byrd*, 261 S.E.2d 655, 656 (N.C. 1980). Therefore, the court will analyze the terms of the Indemnity Agreement under New York law.

"Under New York law, an express trust must have: (1) a designated beneficiary; (2) a designated trustee who is not a beneficiary; (3) an identifiable trust res; and (4) actual delivery or assignment of the trust res with the intent of vesting legal title with the trustee." *Harleysville Worcester Mutual Ins. Co. v. Fleet Nat'l Bank (In re Suprema Specialties, Inc.)*, 2007 U.S. Dist. LEXIS 33937, at *35 (S.D.N.Y. May 7, 2007) (citing *Agudas Chasidei Chabad v. Gourary*, 833 F.2d 431 (2nd Cir. 1987)). In this case, the defendant argues that all four elements are met, and thus a trust is formed. The beneficiaries are designated as the laborers, materialmen, suppliers, subcontractors, and the surety. The debtor is designated as the trustee of the trust. The trust property is defined as "all money or proceeds" on all contracts executed in connection with any bond. Deliver of the trust property occurs when the debtor receives any money or proceeds in connection with any bonded contract. Therefore, according to the defendant the Indemnity Agreement creates an express trust which should be recognized under New York law.

Appendix E

The defendant's analysis inaccurately reflects the law. According to New York law, trust fund assets must be segregated, and "to commingle alleged trust funds with non-trust assets . . . by itself is fatal" to the claim of an express trust. *In re Suprema Specialties, Inc*, 2007 U.S. Dist. LEXIS 33937, at *36. By permitting commingling of funds, an indemnity agreement can prevent the identification of the trust res. *Id.* In the present case, the Indemnity Agreement did not require separate accounts for the funds received by the debtor on bonded projects. Instead the trustee's affidavit stated that the debtor maintained two bank accounts during the year prior to its filing bankruptcy. One account was used as its general operating account in which the debtor deposited all funds it received. The second account was used for payment of the debtor's payroll. The debtor's general practice was to transfer funds into the payroll account from the general operating account as needed. Furthermore, the defendant admitted that all payments it received from the debtor came from the same checking accounting, regardless of whether the payment was for a bonded or non bonded job.

Based on the facts, the court finds that there is clear evidence that the debtor intermingled the monies it received from bonded projects with those it received from non bonded projects. This commingling of alleged trust funds with non-trust funds prevented the identification of the trust res. Since all of the elements of a trust are not present, the funds from the debtor to

the defendant were not trust funds but instead were property of the debtor.[3]

2. Equitable Lien

Independent of the Indemnity Agreement, the defendant asserts that it had an equitable lien in the transferred funds received from the debtor on account of equipment supplied by United Rentals on any construction project. In reaching this result, the defendant relies on *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132, 83 S. Ct. 232 (1962). In *Pearlman*, the Supreme Court determined the subrogation rights of a surety that paid subcontractors on a construction project after the general contractor filed bankruptcy. *Id.* In that case, the government paid funds to the general contractor after it filed bankruptcy that had previously been retained by the government. *Id.* at 134. The trustee took possession of the funds, and the surety sued claiming that it owned the funds. *Id.* The Court held that the retained funds had never become part of the bankruptcy estate, and that "the surety, having paid the laborers and materialmen, is entitled to the benefit of all these rights to the extent necessary to reimburse it." *Id.* at 135-41.

The defendant's argument that the *Pearlman* analysis also applies to subcontractors was recently rejected by the Fourth Circuit. *See Grochal v. Ocean*

3. This flaw in itself is adequate to prevent a trust from being formed under New York law, and therefore the court will not address the merits of the other elements.

Technical Servs. Corp. (In re Baltimore Marine Indus.), 476 F.3d 238, 241-42 (4th Cir. 2007) (holding that surety who has fully paid all subcontractors has a greater right to retained funds than that of an unpaid subcontractor). Therefore, the court rejects the defendant's arguments that based on *Pearlman* the transferred funds never become property of the debtor's estate, and that the defendant holds an equitable lien in the funds which entitles it to priority in payment over all subsequent lienholders and general creditors.

3. Payment From Third Party

Based on the analysis above, the monies paid by the debtor to the defendant were property of the debtor. The defendant additionally argues that had the debtor not paid the defendant, the defendant would have made a claim on the bonds issued in connection with the construction projects. The defendant would have received payment from the general contractor, who would have then withheld monies owed to the debtor. Based on these facts, the defendant did not receive more than it would have received if the transfers had not taken place. The flaw of this argument is that the focus of the fifth element is not on whether the defendant would have received payment from someone else for its claims.[4]

4. Although this argument does not prevent the trustee from establishing the elements of a preferential transfer, it may be used as a new value defense in limited circumstances. *See Partitions Plus of Wilmington, Inc. v. Pennington (In re Partitions Plus of Wilmington, Inc.)*, Case No. 06-00148-8-AP (Bankr. E.D.N.C. June 11, 2007).

Instead, the court must determine whether in a chapter 7 liquidation there would have been enough funds to pay this creditor's claim out of the estate if it had not been preferentially paid. *Smith v. Creative Financial Management, Inc. (In re Virginia-Carolina Financial Corp.)*, 954 F.2d 193, 199 (4th Cir. 1992). The trustee submitted an affidavit that is sufficient to establish that there are inadequate funds to provide a payout in full to unsecured creditors, and this fact is not contested by the defendant. If the defendant had not been preferentially paid, it would not have received the full amount of its claim out of the debtor's estate. Therefore, the trustee has met his burden as to the fifth element, and all the elements of § 547(b) are established.

B. New Value Defense

The defendant's only defense on which it seeks summary judgment is that of new value. Section 547(c)(4) provides that a preferential transfer may not be avoided, "to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor– (A) not secured by an otherwise unavoidable security interest; and (B) on account of which new value of the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor[.] 11 U.S.C. § 547(c)(4). For the purpose of § 547 "new value" is defined as,

> money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such

> transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation[.]

11 U.S.C. § 547(a)(2).

The defendant asserts that certain payments made by the debtor to the defendant were made in exchange for new value in the form of credit extended to the debtor subsequent to receipt of the transferred funds. The trustee does not dispute that the defendant is entitled to some credit against the amount of the preferential payments for subsequent advances of new value pursuant to § 547(c)(4). At the hearing, the trustee conceded that the defendant is entitled to at least a $8885.66 credit for new value.

The court finds, at this time, that the defendant is entitled to a minimum credit of $8885.66 based on new value, and it has the right to try to increase that amount upon an appropriate showing at trial. Additionally, the defendant still has available its other defenses.

CONCLUSION

Based on the forgoing, the plaintiff's motion for summary judgment is ALLOWED. The plaintiff has met his burden of establishing that the defendant received a preferential transfer under § 547(b). The defendant's

motion for summary judgment is granted to the extent a new value credit in the minimum amount of $8885.66 is allowed, and otherwise is DENIED.

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APPENDIX F — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT DENYING PETITION FOR REHEARING FILED FEBRUARY 19, 2010

FILED: February 19, 2010

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 09-1209
(7:08-cv-00097-BO)

UNITED RENTALS, INCORPORATED,

Plaintiff - Appellant

v.

JAMES BIGELOW ANGELL,

Trustee - Appellee

ORDER

The Court denies the petition for rehearing and rehearing en banc. No judge requested a poll under Fed. R. App. P. 35 on the petition for rehearing en banc.

Entered at the direction of the panel: Chief Judge Traxler, Judge Shedd, and Judge Davis.

For the Court
/s/ Patricia S. Connor, Clerk

No. 09-1417

IN THE

Supreme Court of the United States

UNITED RENTALS, INCORPORATED,

Petitioner,

v.

JAMES BIGELOW ANGELL,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

The United States Bankruptcy Code allows a trustee to avoid certain "preferential" transfers made prior to the petition date pursuant to 11 U.S.C. § 547(b). Among the elements of 11 U.S.C. § 547(b) is the requirement that the creditor received more than it would have received if the case were a case under chapter 7 of title 11 of the United States Code (the "Bankruptcy Code"); the transfer had not been made; and the creditor received payment of such debt as provided by the provisions of the Bankruptcy Code. 11 U.S.C. § 547(b)(5).

The Bankruptcy Code provides certain defenses to preferential transfers to creditors under 11 U.S.C. § 547(c), including the contemporaneous "new value" defense under 11 U.S.C. 547(c)(1). A successful assertion of this defense requires that the creditor show that the transfer was intended by the debtor and the creditor to be a contemporaneous exchange for new value given to the debtor; and in fact was a substantially contemporaneous exchange.

In this case, the Appellant, United Rentals, Incorporated ("United Rentals" or "Petitioner") was a lessor of construction equipment to the debtor, Partitions Plus of Wilmington, Inc. ("Partitions"), which served as a subcontractor on various construction projects. United Rentals was owed money on several projects. Although United Rentals had rights to assert claims against a bonding company (the "surety") to obtain payment of its claims or to exercise its rights to obtain liens against the projects under North Carolina law by complying with the statutory procedures to collect

money owed to it, United Rentals made absolutely no efforts to assert bond claims or to obtain statutory liens. United Rentals received payments from Partitions during the 90 day preference period. As Chapter 7 trustee, James B. Angell ("Trustee") brought suit under 11 U.S.C. §547(b) to recover the payments.

This case involves United Rentals' contentions that its unasserted bond claims, which might have resulted in equitable liens in favor of the surety, precluded the trustee from satisfying the provisions of 11 U.S.C.§ 547(b)(5); and that its unasserted bond claims and its unexercised rights to obtain liens under North Carolina law resulted in a new value defense under 11 U.S.C. § 547(c)(1).

Specifically, the questions presented in United Rentals' petition for certiorari are:

1) Does a conflict of law exist among the federal circuits regarding the Fourth Circuit's holding that United Rentals' unasserted bond claims on the construction projects did not enable the United Rentals to receive more than it would have received if the case were a case under chapter 7 of the Bankruptcy Code, the transfer had not been made and United Rentals received payment of such debt as provided under the provisions of the Bankruptcy Code, as is required to be shown under 11 U.S.C. § 547(b)(5)?

2) Does a conflict of law exist among the federal circuits regarding the Fourth Circuit's holding that United Rentals' unasserted bond claims did not result in a transfer intended by Partitions and United Rentals to be a contemporaneous exchange for new value given to Partitions and in fact was a substantially contemporaneous exchange, pursuant to 11 U.S.C. § 547(c)(1)?

3) Does a conflict of law exist among the federal circuits regarding the Fourth Circuit's holding that United Rentals' unexercised rights to obtain liens under North Carolina law did not result in a transfer intended by Partitions and United Rentals to be a contemporaneous exchange for new value given to Partitions and in fact was a substantially contemporaneous exchange, pursuant to 11 U.S.C. § 547(c)(1)?

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STATUTORY PROVISIONS INVOLVED

The Respondent adopts the Petitioner's statement of the Statutory Provisions Involved, however, Petitioner fails to set out the provisions of the North Carolina General Statutes relating to rights of subcontractors, suppliers and/or lessees to obtain liens against property involved in construction projects, as cited in the Fourth Circuit opinion. Those pertinent sections of these statutes are as follows:

N.C. GEN. STAT. § 44A-8. Mechanics', laborers', and materialmen's lien; persons entitled to claim of lien on real property

> Any person who performs or furnishes labor or professional design or surveying services or furnishes materials or furnishes rental equipment pursuant to a contract, either express or implied, with the owner of real property for the making of an improvement thereon shall, upon complying with the provisions of this Article, have a right to file a claim of lien on real property on the real property to secure payment of all debts owing for labor done or professional design or surveying services or material furnished or equipment rented pursuant to the contract.

N.C. GEN. STAT. § 44A-12. Filing claim of lien on real property

(a) Place of Filing. — All claims of lien on real property must be filed in the office of the clerk of superior court in each county where the real property subject to the claim of lien on real property is located. The clerk of superior court shall note the claim of lien on real property on the judgment docket and index the same under the name of the record owner of the real property at the time the claim of lien on real property is filed. An additional copy of the claim of lien on real property may also be filed with any receiver, referee in bankruptcy or assignee for benefit of creditors who obtains legal authority over the real property.

(b) Time of Filing. — Claims of lien on real property may be filed at any time after the maturity of the obligation secured thereby but not later than 120 days after the last furnishing of labor or materials at the site of the improvement by the person claiming the lien.

(c) Contents of Claim of Lien on Real Property to Be Filed. — All claims of lien on real property must be filed using a form substantially as follows:

CLAIM OF LIEN ON REAL PROPERTY

(1) Name and address of the person claiming the claim of lien on real property:

(2) Name and address of the record owner of the real property claimed to be subject to the claim of lien on real property at the time the claim of lien on real property is filed:

(3) Description of the real property upon which the claim of lien on real property is claimed: (Street address, tax lot and block number, reference to recorded instrument, or any other description of real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.)

(4) Name and address of the person with whom the claimant contracted for the furnishing of labor or materials:

(5) Date upon which labor or materials were first furnished upon said property by the claimant:

(5a) Date upon which labor or materials were last furnished upon said property by the claimant:

(6) General description of the labor performed or materials furnished and the amount claimed therefor:

Lien Claimant

Filed this _____ day of _____, _____

Clerk of Superior Court

A general description of the labor performed or materials furnished is sufficient. It is not necessary for lien claimant to file an itemized list of materials or a detailed statement of labor performed.

(d) No Amendment of Claim of Lien on Real Property. – [omitted]

(e) Notice of Assignment of Claim of Lien on Real Property. – [omitted]

(f) Waiver of Right to File, Serve, or Claim Liens as Consideration for Contract Against Public Policy. – [omitted]

N.C. GEN. STAT. § 44A-10. Effective date of claim of lien on real property

A claim of lien on real property granted by this Article shall relate to and take effect from the time of the first furnishing of labor or materials at the site of the improvement by the person claiming the claim of lien on real property.

N.C. GEN. STAT. § 44A-13. Action to enforce claim of lien on real property

(a) Where and When Action Commenced. — An action to enforce a claim of lien on real property may be commenced in any county where venue is otherwise proper. No such action may be commenced later than 180 days after the last furnishing of labor or materials at the site of the improvement by the person claiming the claim of lien on real property. . . .

(b) Judgment. —A judgment enforcing a lien under this Article may be entered for the principal amount shown to be due, not exceeding the principal amount stated in the claim of lien enforced thereby. The judgment shall direct a sale of the real property subject to the lien thereby enforced.

(c) Notice of Action - [omitted]

N.C. GEN. STAT. § 44A-16. Discharge of record claim of lien on real property

Any claim of lien on real property filed under this Article may be discharged by any of the following methods:

(1), (2) [omitted]

(3) By failure to enforce the claim of lien on real property within the time prescribed in this Article.

(4), (5), (6) [omitted]

N.C. GEN. STAT. § 44A-18. Grant of lien upon funds; subrogation; perfection

Upon compliance with this Article:

(1) A first tier subcontractor who furnished labor, materials, or rental equipment at the site of the improvement shall be entitled to a lien upon funds that are owed to the contractor with whom the first tier subcontractor dealt and that arise out of the improvement on which the first tier subcontractor worked or furnished materials.

(2) A second tier subcontractor who furnished labor, materials, or rental equipment at the site of the improvement shall be entitled to a lien upon funds that are owed to the first tier subcontractor with whom the second tier subcontractor dealt and that arise out of the improvement on which the second tier subcontractor worked or furnished materials. A second tier subcontractor, to the extent of the second tier subcontractor's lien provided in this subdivision, shall also be entitled to be subrogated to the lien of the first tier subcontractor with whom the second tier

> contractor dealt provided for in subdivision (1) of this section and shall be entitled to perfect it by notice of claim of lien upon funds to the extent of the claim.

(3), (4), (5) [omitted]

(6) A lien upon funds granted under this section is perfected upon the giving of notice of claim of lien upon funds in writing to the obligor as provided in G.S. 44A-19 and shall be effective upon the obligor's receipt of the notice. The subrogation rights of a first, second, or third tier subcontractor to the claim of lien on real property of the contractor created by Part 1 of Article 2 of this Chapter are perfected as provided in G.S. 44A-23.

N.C. GEN. STAT. § 44A-23. Contractor's claim of lien on real property; perfection of subrogation rights of subcontractor.

(a) First tier subcontractor. — A first tier subcontractor, who gives notice of claim of lien upon funds as provided in this Article, may, to the extent of this claim, enforce the claim of lien on real property of the contractor created by Part 1 of this Article. The manner of such enforcement

shall be as provided by G.S. 44A-7 through 44A-16. The claim of lien on real property is perfected as of the time set forth in G.S. 44A-10 upon filing of the claim of lien on real property pursuant to G.S. 44A-12. Upon the filing of the claim of lien on real property, with the notice of claim of lien upon funds attached, and the commencement of the action, no action of the contractor shall be effective to prejudice the rights of the subcontractor without his written consent.

(b) Second or third subcontractor. –

(1) A second or third tier subcontractor, who gives notice of claim of lien upon funds as provided in this Article, may, to the extent of his claim, enforce the claim of lien on real property of the contractor created by Part 1 of Article 2 of the Chapter except when:

(a), (b) [omitted]

(2), (3) [omitted]

(4) The manner of such enforcement shall be as provided by G.S. 44A-7 through G.S. 44A-16. The

> lien is perfected as of the time set forth in G.S. 44A-10 upon the filing of a claim of lien on real property pursuant to G.S. 44A-12. Upon the filing of the claim of lien on real property, with the notice of claim of lien upon funds attached, and the commencement of the action, no action of the contractor shall be effective to prejudice the rights of the second or third tier subcontractor without his written consent.

STATEMENT OF THE CASE

The Respondent accepts Petitioner's statement of the case with the following corrections and clarifications:

United Rentals contends that the Fourth Circuit's decision in this case conflicts with the decisions of other circuits and creates an inequitable scenario where a construction contractor is prejudiced by accepting payment for its work. Petition for a Writ of Certiorari ("Brief"), p. 4. The prejudice of recovery of a preferential payment is no greater than that applicable to a general unsecured creditor, including a general unsecured creditor that could have obtained a judgment lien or other lien, but failed to do so.

United Rentals contends that there are clear conflicts between the decisions of other circuits and the Fourth Circuit. Brief, p. 5. As shown below, United Rentals has shown no conflicting decisions because the Fourth Circuit's decision was based on its undisputed finding that United Rentals never asserted a bond claim or took any action to obtain a lien under North Carolina's lien laws. Based on these findings, the Fourth Circuit found that United Rentals did not have a security interest in property of the estate and the surety providing the bond did not have an equitable lien against property of the debtor. The cases cited by United Rentals are generally based on facts where liens were provided by statute without conditions, the defendant exercised its rights to assert a lien under state law, or the defendant asserted a claim against the surety.

The Trustee disputes the contentions made by United Rentals concerning the consequences of the Fourth Circuit decision. Brief, pp. 5-6. The North Carolina lien statutes and payment bonds grant subcontractors such as United Rentals rights to exercise remedies if payment is not timely made. These protections are in place to allow creditors to assert priorities to protect themselves. The state law policies of assisting subcontractors in obtaining payment are determined by state law and are simply part of the substantive law that must be taken into account in determining rights in bankruptcy cases.

United Rentals asserts that North Carolina law gives a subcontractor "a lien on funds that are owed to the contractor", citing N.C. GEN. STAT. § 44A-18 (2010). Brief, p. 7. In citing the statue, United Rentals omits

the language in the statute providing conditions to the lien, that it is granted "(u)pon compliance with this Article" and requires service of a notice of the lien on the obligor. N.C. GEN. STAT. §44A-18(6). Similarly, United Rentals omitted that the claim of lien to be filed under N.C. GEN. STAT. §44A-12 is filed pursuant to the provisions of N.C. GEN. STAT. §44A-8 and N.C. GEN. STAT. §44A-23, which provide a mere "right to file a claim of lien on real property" "upon complying with the provisions of this Article", which is available to a subcontractor "who gives notice of claim of lien upon funds as provided in this Article." The liens are not effective and the subcontractor has no rights to these liens without compliance with these statutes.

United Rentals asserts that the evidence in the Bankruptcy Court showed that "owners and contractors on both projects were holding funds in excess of the alleged preferential payments both at the time of the transfers and at the time of the bankruptcy petition." Brief, p. 10. The Bankruptcy Court made no such finding and merely found that "the only evidence that United Rentals presented at trial . . . [was] whether there were sufficient funds owing to the debtor general contractor on which the bonding company could have asserted a lien." App. D, p. 37a.

REASONS FOR DENYING THE PETITION

I. *Summary of the decision below.*

The Fourth Circuit's decision, App A (the "Fourth Circuit Decision") is expressly based on its affirmation of the Bankruptcy and District Courts' findings that United Rentals was an unsecured creditor when the payments were received. App. A, pp. 13a, 15a. United Rentals did absolutely nothing to exercise its rights under North Carolina law to obtain liens against the projects, and United Rentals took no actions to assert any claims against the bonding company based on payment bonds for the projects. App. A, p. 6a.

In its Petition, United Rentals argues that there are conflicts between the circuits as to issues under 11 U.S.C. § 547(b)(5) (hereinafter "§ 547(b)(5)") and 11 U.S.C. §547(c)(1) (hereinafter "§547(c)(1)"). Brief, pp. 15-32. However, a review of the cases cited by United Rentals shows that the creditors in those cases had taken some action to assert claims against the bonding companies or were entitled to existing liens under the applicable state statutes. The cases cited by United Rentals are therefore distinguishable on their facts, and no real conflict exists.

The Fourth Circuit addressed the lien law issues based on its reading of the North Carolina statutes, App. A, pp. 14a-17a, which is facially consistent with the language of those statutes, and not in conflict with any North Carolina precedents.

The Fourth Circuit's findings with respect to the bond claims are simply based on the fact that no bond claims were asserted by United Rentals and are consistent with precedent that a surety's equitable lien rights arise upon payment. App. A, p. 13a. The cases cited by United Rentals involve asserted bond claims or other secured claims existing at the time of payment and do not apply to the facts in this case, in which no bond claims were asserted.

Therefore, there is no conflict with the other circuits as argued by United Rentals because the cases it cites involve creditors who made claims on bonds or had existing liens under applicable state law.

A. *The Fourth Circuit's Finding as to Property Rights regarding United Rentals' Bond Claims.*

United Rentals did not contend and does not now contend that it took any actions to assert any claims against the surety under the bonds.

United Rentals asserted, in support of its argument that the Trustee failed to establish the requirements of § 547(b)(5) and its new value defense under § 547(c)(1) that it had claims against the surety based on payment bonds on the various projects. App. A., pp. 5a, 6a. Its argument under § 547(b)(5) was that, had it asserted claims against the surety, the surety would have paid the claims in full. App. A, p. 9a. Its argument under § 547(c)(1) was that payment resulted in money that Partitions received from general contractors that might have been instead paid to the surety had the surety paid a bond claim. App. A, p. 13a.

In rejecting United Rentals' arguments under §547(c)(1), the Fourth Circuit addressed the basis of United Rentals' contentions regarding the surety's property rights directly: "Since United never even attempted to make any claim on the bond here, the Surety never obtained any lien that it could release . . . the only benefit that United showed the Debtor was given, as part of the contemporaneous exchange for the transfers, was the extinguishment of its debt." App. A. pp. 13a, 14a.

B. *The Fourth Circuit's Finding as to Property Rights regarding United Rentals' Rights to Obtain Liens under North Carolina Law.*

United Rentals did not contend and does not now contend that it took any actions to exercise its rights to obtain a lien under North Carolina's lien statutes.

United Rentals did not present the issue of whether its unexercised rights to obtain liens under North Carolina law defeated the requirements of § 547(b)(5) at trial and that issue was not considered on appeal. App. A, p. 9a, n.2.

United Rentals argued under § 547(c)(1) that new value was given to the debtor in the form of money that Partitions retained by not having to face offset claims that would result if United Rentals exercised its lien rights. App. A, pp. 14a, 15a. United Rentals also argued that new value was given in the discharge of its inchoate lien rights under North Carolina law. App. A, p. 15a. In support of its arguments, United Rentals argued that North Carolina law provided it with a security interest

in the owners' property at the time of the transfers. App. A, p. 15a.

The Fourth Circuit addressed these contentions directly. "United claims that it held a security interest in the owners' properties at the time of the transfers . . . because the mechanic's lien statutes immediately grant a security interest to a supplier who furnishes labor or material to improve the property . . . However, just as the Surety did not have an equitable lien to release since it had not paid a claim on the bond, United did not have a security interest to release because it never filed the mechanic's lien claim necessary to obtain such an interest . . . Because United had not filed such a claim when the transfers were made, no interest had been transferred to United and United had no interest to release." App. A, pp. 15a-17a.

C. *The Fourth Circuit's Ruling under §547(b)(5) regarding United Rentals' unasserted bond claims.*

The Fourth Circuit found, with respect to §547(b)(5), the "inquiry focuses 'not on whether a creditor may have recovered all of the monies owed by the debtor *from any source whatsoever*, but instead upon whether the creditor would have received less than a 100% payout' from the bankruptcy estate." App. A, pp. 9a, 10a. Since United Rentals' argument was that it would have received payment from the surety had it not been paid and asserted a bond claim, and not that it would have received full payment from Partitions of its claims as provided under the provisions of the Bankruptcy Code, the Fourth Circuit upheld the lower court rulings.

D. *The Fourth Circuit's Ruling under §547(c)(1) regarding United Rentals' unasserted bond claims.*

The Fourth Circuit addressed United Rentals' contentions that United Rentals' unasserted claims against the bonds resulted in an "indirect transfer" of new value under § 547(c)(1) based on the money that Partitions was eventually paid that the surety could have received directly from the general contractor had United Rentals enforced its bond rights.[1] App. A, pp. 11a, 12a, citing *O'Rourke v. Seaboard Surety Co. (In re Fegert, Inc.)*, 887 F.2d 955 (9th Cir. 1989). The Fourth Circuit found that "without deciding the correctness of the *Fegert* court's conclusion that the release of the surety's security interest in that case constituted "new value" contemporaneously received by the debtor, we conclude that that was not the case on the facts before us" because "United never even attempted to make any claim on the bond here" such that the surety never had any interest it could release. App. A, p. 13a.

The Fourth Circuit also reasoned that the value in the form of money that might eventually be received by Partitions from the general contractors that otherwise might have been paid to the surety could not be contemporaneous exchange of new value because it could not be shown when these funds might be received. App. A, pp. 13a - 14a. The Fourth Circuit also held that

[1] The Fourth Circuit found that United Rentals "does not even argue to us that the Debtor received new value by virtue of the removal of the possibility that any such lien would ever be created." App. A, p. 13a.

United Rentals had produced no evidence that Partitions and United Rentals intended the transfer as a contemporaneous exchange of new value. App. A, p. 14a.

E. *The Fourth Circuit's Ruling under §547(c)(1) regarding United Rentals' unexercised rights to obtain liens under North Carolina law.*

In ruling against United Rentals' contentions that its unexercised rights to obtain liens under North Carolina law resulted in a "new value" defense under §547(c)(1), the Court found that "just as the Surety did not have an equitable lien to release since it had not paid a claim on the bond, United did not have a security interest to release because it never filed the mechanic's lien claim necessary to obtain such an interest." App. A, p. 15a.

Finally, the Fourth Circuit rejected United Rentals' contentions that the Debtor retained money by not having to face offset claims that the property owner would have gained from enforcement of United Rentals' rights under North Carolina law to obtain a lien, and that discharge of United's inchoate lien rights constitutes new value. App. A, p. 15a. The basis of its decision was that "United never had a security interest to release because it never filed the mechanic's lien claim necessary to obtain such an interest" under North Carolina law. App. A, p. 15a.

II. *The Fourth Circuit decision is not in conflict with the cases from other circuits cited by United Rentals because those cases involve creditors who asserted bond claims or had existing lien rights under applicable state law.*

The decisions of other Circuits cited in United Rentals' Brief are generally distinguishable from the Fourth Circuit decision below because they are based on bond claims that were actually asserted or lien remedies that were actually exercised or otherwise involved liens that existed when the payment was made. Because of these factual distinctions, there is no conflict among the circuits. As to the lien laws, the findings of the Fourth Circuit are based on the specific provisions of North Carolina's lien statutes, are not in conflict with the North Carolina decisions cited by United Rentals, and do not raise issues of general applicability across the circuits.

In its Brief, United Rentals further obscures the issue involved in the Fourth Circuit decision by failing to distinguish between its arguments posed in the courts below under §547(b)(5) and §547(c)(1).

A. *The Fourth Circuit decision under §547(b)(5) relating to United Rentals' unasserted bond claims is consistent with the decisions of the Sixth Circuit and other circuits.*

In holding that "the § 547(b)(5) inquiry focuses 'not on whether a creditor may have recovered all of the monies owed by the debtor *from any source whatsoever*, but instead upon whether the creditor would have

received less than a 100% payout' from the bankruptcy estate," the Fourth Circuit treated United Rentals as an unsecured creditor. App A, pp. 9a, 10a (*citing Smith v. Creative-Financial Mgmt., Inc. (In re Virginia-Carolina Fin. Corp.)*, 954 F.2d 193, 199 (4th Cir. 1992)).

Under § 547(b)(5), the Court must determine that the transfer enables such creditor to get more than he would receive if (A) the case were a case under chapter 7 of the Bankruptcy Code; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of the Bankruptcy Code. In making its determination, the court must decide the transferee's creditor class and determine what distribution that class would have received had the transfer not been made. *See* 11 U.S.C. §§ 506, 726(a).

United Rentals argues that there is a conflict among the circuits based on different statements of the legal standard as whether a voidable preference must diminish the estate as opposed to whether a creditor would have received less than a 100% payout' from the bankruptcy estate. Brief, pp. 17-18. This presents a false choice to the Court and a false conflict. Although, the diminishment rule generally applies in determining whether § 547(b)(5) applies, the 100% rule is a special application of that rule applicable to unsecured claims, such as the claims of United Rentals in this case. In fact, these principles are completely consistent in the case of a general unsecured claim, as set out in *Palmer Clay*

Products Co. v. Brown, 297 U.S. 227 (1936), a case decided under the Bankruptcy Act:

> Whether a creditor has received a preference is to be determined . . . by the actual effect of the payment as determined when bankruptcy results. The payment on account of say 10% within the four months will necessarily result in such creditor receiving a greater percentage than other creditors, if the distribution in bankruptcy is less than 100%. For where the creditor's claim is $10,000, the payment on account $1000, and the distribution in bankruptcy 50%, the creditor to whom the payment on account is made receives $5500, while another creditor to whom the same amount was owing and no payment on account was made will receive only $5000. *A payment which enables the creditor "to obtain a greater percentage of his debt than any other of such creditors of the same class" is a preference.*

Id. at 229 (emphasis added).

Smith v. Creative-Financial Mgmt., Inc. (In re Virginia-Carolina Fin. Corp.), 954 F.2d 193, 199 (4th Cir. 1992) follows the *Palmer Clay* case and distinguishes between creditors having secured claims and those having unsecured claims. The *Smith* Court cites *Small v. Williams*, 313 F.2d 39, 44 (4th Cir. 1963), holding that, in the case of a secured claim, "payment upon a secured claim which has the effect of 'releasing assets of comparable value to the claims of general creditors is

not preferential because it does 'not deplete the debtor's estate or diminish the assets available for distribution among general creditors." The *Smith* Court in addressing the preference payments made to an unsecured creditor, as in this case, found that the applicable standard under §547(b)(5) was whether the creditor would have received less than a 100% payout in Chapter 7 liquidation." 954 F.2d at 199. The conflict between the circuits alleged by United Rentals is based on a misreading of these cases.

Cases within the Fifth, Sixth, Seventh, Eighth, Tenth and Eleventh circuits, cited by United Rentals as being in conflict with the Fourth Circuit, use the same rules for determining whether a transfer has a preferential effect under § 547(b)(5): In the case of a payment to an unsecured, nonpriority creditor, the preferential effect requirement is satisfied unless general, unsecured creditors would have received 100% of their claims in the hypothesized Chapter 7 distribution. *Compare Smith v. Creative-Financial Mgmt., Inc.*, 954 F.2d 193, 199, *with Lowe v. Palmetco, Inc. (In re NA Flash Found., Inc.)*, 541 F.3d 385, 389 (5th Cir. 2008) (stating that the preference statute was designed "to prevent a transfer to one creditor that would diminish the estate of the debtor" applying "the relevant inquiry focuses not on whether a creditor may have recovered all of the monies owed by the debtor from any source whatsoever, but instead on whether the creditor would have recovered 100% of the debt from the debtor's estate."); *Still v. Rossville Bank (In re Chattanooga Wholesale Antiques, Inc.)*, 930 F.2d 458, 465 (6th Cir. 1991) ("Unless the estate is sufficient to pay a 100% distribution, any unsecured creditor . . . who

receives a payment during the preference period is in a position to receive more than it would have received in a chapter 7 liquidation."); *Maxwell v. Amtex Systems, Inc. (In re marchFirst, Inc.)*, 2007 Bankr. LEXIS 4761 (7th Cir. Bankr. N.D. Ill. 2007)(the issue is whether "unsecured creditors would have received less than 100% of their claims."); *In re Kroh Brothers Development Co.*, 86 B.R. 186 (8th Cir. Bankr. W.D. Mo. 1988), *aff'd* 973 F.2d 671(8th Cir. 1992) ("if distribution in bankruptcy to unsecured creditors is less than 100 percent, any payment to an unsecured creditor during the preference period enables that creditor to receive more than he would have received in liquidation had the payment not been made"); *Connolly v. Fiber Instrument Sales, Inc. In re Western Integrated Networks, LLC)*, 2006 Bankr. LEXIS 2970, 46 Bankr. Ct. Dec. (LRP) 281 (B.A.P. 10th Cir. 2006) ("Fortunately, the courts have recognized certain shorthand tests for deciding if a transfer had a preferential effect. The most commonly used test is as follows: In the case of a payment to an unsecured, nonpriority (general) creditor, the preferential effect requirement is satisfied unless general, unsecured creditors would have received 100% of their claims in the hypothesized Chapter 7 distribution."); *Flatau v. Tribble's Shoes, Inc. (In re Lawrence)*, 82 B.R. 157, 160 (11th Cir. Bankr. M.D. Ga. 1988)(the issue is whether "Plaintiff has shown that a one hundred percent distribution to unsecured creditors is not possible."). These cases demonstrate that the 100% test applicable to unsecured creditors is an application of the general "diminution" rule and that the two rules are compatible and not in conflict.

Although United does not contend it was a secured creditor for the purposes of § 547(b)(5), it contends that, although it did nothing whatsoever to assert its bond claim, it should be entitled to assert the equitable subrogation rights available to a surety as described in the case of *Pearlman v. Reliance Insurance Company*, 371 US. 132 (1962). Brief, pp. 18, 19. It contends that these equitable subrogation rights would have resulted in no diminishment of the estate because these rights would have resulted in the surety being fully secured in the amount of the payment. Brief, pp. 18, 19.

Pearlman itself is distinguishable from the facts of this case. *Pearlman* involved a surety that paid for the completion of a bonded project, and asserted that its equitable rights to the contract balance were superior to those of the bankruptcy trustee. *Pearlman*, 371 U.S., at 133-134. The Supreme Court cited the "already established doctrine that a surety who completes a contract has an "equitable right" to indemnification out of a retained fund . . . here the surety incurred his losses by paying debts for the contractor rather than by finishing the contract. *Id.* at 138. In this case, United Rentals accepted payment from the debtor instead of receiving payment from the surety. *Id.* The equitable lien of the surety ever came into effect. App. A, p. 13a.

United Rentals cites *O'Rourke v. Seaboard Surety Co. (In re Fegert, Inc.)*, 88 B.R. 258 (B.A.P. 9th Cir. 1988) to support its assertion that its unexercised bond claims resulted in "new value" under § 547(c)(1), Brief, p. 24. In this context, the Fourth Circuit recognized the *Fegert* decision as holding that "the release of the surety's security interest in that case constitutes 'new value'

contemporaneously received by the debtor," but concluded "that that was not the case on the facts before us . . . since United never even attempted to make any claim on the bond . . . the Surety never obtained any lien that it could release." App. A, p. 13a.

United Rentals misstates the basis of the Fourth Circuit decision. First, the Fourth Circuit holds that the court must look solely to the payment that the creditor would receive from the estate, not from the surety.

Even applying United Rentals' "indirect transfer" theory to § 547(b), as it seems to argue in claiming that the estate was not diminished, the Fourth Circuit did not find that § 547(b) is "satisfied when the estate would not be diminished by the transfers." Brief, p. 23. The Fourth Circuit found that the basis of United Rentals' assertion that the payment did not diminish the estate, *i.e.*, the surety's equitable lien, did not exist because United Rentals never filed a bond claim. As such, United Rentals was treated as an unsecured creditor and the 100% rule applied. The cases cited by United Rentals that apply to secured claims of preference defendants or sureties simply do not apply in this case because there were no secured claims involved in this case.

Since United Rentals did nothing to assert its claims against the sureties in this case, United Rentals' reliance on *Pearlman* and *Fegert* is misplaced. As such, it is an unsecured creditor in the debtor's bankruptcy case and the surety did not obtain the equitable lien rights found to exist in those cases. The 100% standard applicable to nonpriority unsecured creditors is consistent with the diminution standard generally applied to determine the

preferential effect of the transfer under § 547(b)(5) in the Fifth, Sixth, Seventh, Eighth and Tenth circuits. There is no conflict between the circuits based on the facts in this case.

B. *The Fourth Circuit's decision did not address whether United Rentals' unexercised lien rights under North Carolina law resulted in no diminution of the estate under § 547(b) because United Rentals failed to preserve the issue for appeal.*

United Rentals argues "The Fourth Circuit has rejected and is in conflict with [the] decisions of the Second and Ninth Circuits holding that there is no preferential transfer if unperfected state law inchoate mechanic's lien rights are released, resulting in no diminution of the estate." Brief, p. 32.

This issue was not raised by United Rentals in the Bankruptcy Court on the Trustee's motion for summary judgment under § 547(b), App. E, pp. 43a-48a, and this issue was not considered by the Fourth Circuit. The Fourth Circuit found that United Rentals failed to preserve the issue of whether, under §547(b)(5), "had the transfers not been made, United would . . . have obtained full payment from the hypothetical Chapter 7 estate by enforcing its lien rights and thereby attaining secured-creditor status." App. A, p. 9a, n.2. As noted by the Fourth Circuit, United Rentals based its argument at the summary judgment hearing on §547(b) on whether the transfers were avoidable "because United would have received full payment from the Surety by enforcing its bond rights had the Debtor not made the

transfers." App. A, p. 5a, App. E, pp. 47a, 48a. This Court should not indulge United Rentals' efforts to raise this issue once again on a petition for certiorari where it was not preserved at the trial court level.

C. *The Fourth Circuit decision under §547(c)(1) relating to United Rentals' unasserted bond claims is consistent with the decisions of the Sixth Circuit and other circuits.*

As noted above, the Fourth Circuit rejected United Rentals' contention that the surety had a lien based on equitable subrogation where United Rentals did nothing to assert a bond claim. App. A, p. 13a.

Despite United Rentals' best efforts to portray the Fourth Circuit decision in this case as in conflict with the *O'Rourke v. Seaboard Surety Co. (In re Fegert, Inc.)*, 887 F.2d 955 (9th Cir. 1989) decision in the Ninth Circuit, Brief, p. 23-26, the Fourth Circuit decision identified a factual basis for distinguishing the Ninth Circuit decision in the *Fegert* case. In fact, the Fourth Circuit scrupulously reserved the issue for another day, in making its ruling "[w]ithout deciding the correctness of the *Fegert* court's conclusion that the release of the surety's security interest in that case constituted 'new value' contemporaneously received by the debtor." App. A, p. 13a.

The facts in *Fegert* are distinguishable from the facts in this case. In *Fegert*, the subcontractors sued the debtor and the surety for payment of their claims. In this case, "United never even attempted to make any claim on the bond". App. A, p. 13a. Had United Rentals

made a claim on the bond by filing suit, the Fourth Circuit would have been squarely presented with the *Fegert* issue. Similarly, *Fegert* is not controlling in the Ninth Circuit where the subcontractor has not made a claim on the bond. Because the Fourth Circuit found that the surety never had a lien that it could release due to United Rental's failure to even make a claim on the bond, the decisions are based on different facts and are not in conflict.

Similarly, United argues that the Fourth Circuit decision is contrary to the Fifth Circuit decision of *Gulf Oil Corporation v. Fuel Oil Supply & Terminating, Inc. (In re Fuel Oil Supply & Termininating, Inc.)*, 837 F.2d 224 (5th Cir. 1988) and the Ninth Circuit decision of *Committee of Creditors holding Unsecured Claims v. Koch Oil Company (In re Powerine Oil Company)*, 59 F3d 969 (9th Cir. 1995) *cert. denied* 516 US 1140 (1996). Brief, pp. 27-29. Both of these decisions involved facts in which the creditor had the right to call a letter of credit that was secured by an existing lien on property of the estate. In this case, the Fourth Circuit held that there was no lien created in favor of the Surety that could be released. App. A, p. 11a. These cases are therefore distinguishable on their facts, and there is no conflict between these decisions and the Fourth Circuit's decision.

D. *The Fourth Circuit's decision under § 547(c)(1) relating to United Rentals' unexercised rights to obtain liens under North Carolina law is not in conflict with the decisions of the Supreme Court or the Circuit courts applying the lien laws of other states.*

United Rentals again seeks to obscure a ruling on the facts of this case in contending that the Fourth Circuit decision is in conflict with other circuits. With regard to United Rentals' claims under § 547(c)(1), the Fourth Circuit held, that "just as the Surety did not have an equitable lien to release since it had not paid a claim on the bond, United did not have a security interest to release because it never filed the mechanic's lien necessary to obtain such an interest." App. A, p. 15a.

United Rentals contends that the use of the term "inchoate" by the North Carolina courts in describing rights to obtain liens under Chapter 44A of the North Carolina General Statutes is conclusive on the federal court in determining that a lien presently exists. Brief, pp. 29-30. United Rentals completely miscites *United States v. Security Trust & Savings Bank*, 340 U.S. 47 (1950) to support its position that its unexercised lien rights under North Carolina law resulted in a lien. Brief, p. 29. Specifically, *Security Trust* states that:

> The effect of a lien in relation to a provision of federal law for the collection of debts owing the United States is always a federal question. Hence, although a state court's classification of a lien as specific and perfected is entitled to weight, it is subject to reexamination by

> this Court. On the other hand, *if the state court itself describes the lien as inchoate, this classification is "practically conclusive." Illinois v. Campbell*, 329 U.S. 362, 371. The Supreme Court of California has so described its attachment lien in the case of *Puissegur v. Yarbrough*, 29 Cal. 2d 409, 412, 175 P. 2d 830, 831, by stating that, "*The attaching creditor obtains only a potential right or a contingent lien . . .*"

Security Trust, 340 U.S. at 49-50 (emphasis added).

In *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362 (U.S. 1946), cited in *Security Trust*, the Supreme Court was called upon to review a decision of the Illinois Supreme Court that a federal lien was superior to a lien arising under Illinois law. The Illinois Supreme Court had held that the lien under Illinois law was "inchoate" such that the federal lien enjoyed priority. 329 U.S. at 371. The Court held:

> The priority given the United States cannot be impaired or superseded by state law." *United States v. Oklahoma*, 261 U.S. 253, 260. Hence a state court's characterization of a lien as specific and perfected is not conclusive. *United States v. Waddill Co.*, 323 U.S. 353, 357. The state characterization, though entitled to weight, is always subject to reexamination by this Court.
>
> On the other hand, if the state court itself characterizes the lien as inchoate, this

> characterization is practically conclusive. "Whatever might have been the effect of more completed procedure in the perfecting of the liens under the law of the State, upon the priority of the United States herein, the attitude of the state court relieves us of consideration of it." *Spokane County v. United States*, 279 U.S. 80, 95; *cf. United States v. Knott*, 298 U.S. 544.

Id. What the Court was saying was that if the state court finds that the lien is "inchoate", the federal court may consider the lien to be unperfected without further inquiry.[2]

Although the North Carolina cases cited by United Rentals use the term "inchoate" in describing the liens, United Rentals cites no case under North Carolina law finding that an "inchoate" materialman's lien is a presently effective lien. Brief, pp. 29, 30. The use of the term "inchoate" in North Carolina decisions is without any definition in terms of its effectiveness or priority, it is simply a short-hand manner of describing a materialman's rights to obtain a lien by complying with the provisions of the North Carolina statutes, whatever those rights may be. *See* App. A, pp. 15a-17a. As to the Fourth Circuit's characterization of the rights are a "right to file a mechanic's lien", the Fourth Circuit is

[2] Although United Rentals asserts that an "inchoate" lien is an existing interest, an "inchoate interest" is a "property interest that has not yet vested". *Rossiter v. Simon (In re Rossiter)*, 412 B.R. 677, 683 (D.N.J. 2008)(citing Black's Law Dictionary 816 (7th ed. 1999)).

merely tracking the language of N.C. GEN. STAT. § 44A-8, holding that a contractor "shall, *upon complying with the provisions of this Article*, have a *right to file a claim of lien on real property* on the real property to secure payment for all debts owing for" services performed, materials provided, or leased property. *See also* N.C. GEN. STAT. § 44A-23(b)(1) ("A second or third tier subcontractor, *who gives notice of claim of lien upon funds as provided in this Article, may,* to the extent of his claim, enforce the claim of lien on real property of the contractor . . .").

United Rentals contends that the Second Circuit's decision in *Ricottta v. Burns*, 264 F.2d 749 (2d. Cir. 1959) results in a conflict with the Fourth Circuit decision. Brief, pp. 30, 31. Although *Ricotta*, decided under the Bankruptcy Act, found that the trustee could not avoid a payment for building materials furnished to a bankrupt debtor where the defendant could have filed a materialman's lien for the same debt under New York's lien law, subsequent decisions in the Second Circuit have rejected that the analysis in the *Ricotta* case applies to the "new value" defense under §547(c)(1), *Official Comm. of Unsecured Creditors of 360Networks (USA) Inc. v. AAF-McQuay, Inc. (In re 360 Networks (USA), Inc.)*, 327 B.R. 187, 191 (Bankr. S.D.N.Y. 2005) ("Contrary to the Debtors' contention, *Ricotta* was not decided on the basis of a new value argument and, in fact, the decision makes no mention of new value.") or that *Ricotta* applies where the lien asserted under New York is asserted against property that is not the debtor's property, *Buchwald Capital Advisors, L.L.C. v. Metl-Span I, Ltd. (In re Pamleco Corp.)*, 356 B.R. 327, 336 (Bankr. S.D.N.Y. 2006)("*Ricotta* . . . dealt with a

statutory lien that would have been imposed directly upon the debtor's property and [is] inapposite under the facts of this case."). In fact, the *360Networks* decision expressly holds that the release of a right to perfect a lien is not included in the Bankruptcy Code's definition of "new value." *360Networks*, 327 B.R. at 192.

The basis of the Second Circuit's decision in *Ricotta*, as clarified by these cases, is important in that it demonstrates that the facts are distinguishable from the present case, in which United Rentals asserts it could have filed liens against property owned by others. Brief, pp. 7-8. Subsequent decisions make it clear that the Second Circuit has not passed on the issue of whether unexercised lien rights constitute "new value" under § 547(c)(1)[3]; and that the Second Circuit has not passed on the issue of whether unexercised rights to obtain liens on property other than property of the debtor under applicable state law constitutes new value. The *Ricotta* decision in inapposite to the issues decided in the Fourth Circuit's decision.

Although United Rentals cites *Miller v. Wells Fargo Bank International Corp.*, 540 F.2d 548 (2d Cir. 1976) as another decision in conflict with the Fourth Circuit decision, Brief, p. 31, this case does nothing more than distinguish the bank liens involved in that case from those involved in *Ricotta*. As such, *Miller* simply cites *Ricotta* and distinguishes it without adding to the legal analysis of the Second Circuit as to these issues. 540 F.2d at 564, 565.

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[3] Solely for the sake of making this point, the Trustee ignores that there may be distinguishing differences between North Carolina's lien laws and those of New York.

The Ninth Circuit's decision in *Greenblatt v. Utley*, 240 F.2d 243 (9th Cir. 1956) cited by United Rentals as another conflicting circuit, Brief, pp. 31, 32, is factually distinguishable based on the broad lien granted by California law. Instead of providing a subcontractor with a "right to file a lien", as provided under North Carolina law, App. A, pp. 16a-17a, the California statute applicable in that case provided that:

> 'Liens of construction mechanics, materialmen, contractors, etc. — Mechanics, materialmen, contractors, subcontractors, artisans, architects, machinists, builders, teamsters and draymen, and all persons and laborers of every class performing labor upon or bestowing skill or other necessary services on, or furnishing materials to be used or consumed in, or furnishing appliances, teams, or power, contributing to, the construction, alteration, addition to, or repair, either in whole or in part, of, any building, structure, or other work of improvement ***shall have a lien upon the property*** upon which they have bestowed labor or furnished materials or appliances for the value of such labor done or materials furnished and for the value of the use of such appliances, teams, or power, whether done or furnished at the instance of the owner or of any person acting by his authority or under

> him, as contractor or otherwise.' (emphasis added)[4]

Greenblatt, 240 F.2d at 246 (*citing* C.C.C.P. 1181 (*repealed by* C.C.C.P. 1362 § 3, operative January 1, 1971)).

In contrast to California's statute, which provided a lien without the prerequisite of complying with filing and notice procedures, the rights provided to a subcontractor under North Carolina are conditioned on the subcontractor taking certain actions that were not taken by United Rentals in this case. App. A, pp. 15a-17a. The Fourth Circuit held that "[b]ecause United had not filed such a claim when the transfers were made, no interest had been transferred to United, and United had no such interest to release." App. A., p. 17a. Based on the differences in state law, the Ninth Circuit did not decide whether forbearance of the mere right to obtain a lien constitutes "new value".

[4] United Rentals cites N. C. Gen. Stat.§44A-18 as stating that North Carolina law gives a subcontractor " a lien upon funds that are owed to the contractor with whom the . . . . subcontractor dealt. . . ." United Rentals omitted that the statute provides that the lien is conditioned "(u)pon compliance with this Article" *See* Brief, p. 7; *compare* N.C. Gen. Stat.§44A-18. United Rentals' failure to give proper weight to the specific provisions of North Carolina law governing materialmen's liens is demonstrated by its failure to include those provisions in its statement of the Statutory Provisions Involved. Brief, pp. 2-3.

III. *The decision below does not implicate decisions of national importance.*

Lien laws. Creditors' entitlements in bankruptcy arise from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary Bankruptcy Code provisions. *See Butner v. United States*, 440 U.S. 48, 55, 59 L. Ed. 2d 136, 99 S. Ct. 914 (1979). The basic federal rule in bankruptcy is that state law governs the substance of claims. *Id.* at 57; *Raleigh v. Ill. Dep't of Revenue*, 530 U.S. 15, 19, 147 L. Ed. 2d 13, 17, 120 S. Ct. 1951, 1955 (2000). Therefore, the rights of United Rentals as to materialmen's liens are governed by North Carolina's lien laws.

United Rentals attempts to create issues of national importance by ignoring specific provisions of North Carolina's lien laws and by categorically referring to North Carolina's lien law and lien laws of other states available to equipment lessors on construction projects as "inchoate mechanic's lien rights" and "state created lien rights." Brief, p. 29. As found by the Fourth Circuit, North Carolina's lien laws provide "only a right to file a mechanic's lien, which United did not do here." App. A, p. 16a. In contrast, other states have laws that grant liens without conditions, such as the California statue cited in *Greenblatt*, above. North Carolina's lien law provisions and the substantive rights of subcontractors thereunder are limited in applicability to the scope of the statutes, *see* N.C. GEN. STAT. Chapter 44A, Articles 1-3, are not uniform with the laws of other states and are not nationwide in their application.

Furthermore, a subcontractor has the ability to avoid the application of the Fourth Circuit decision by exercising its lien rights to obtain the benefits of the liens provided to them under N.C. General Statutes, Chapter 44A. The ordinary course of business defense under 11 U.S.C. § 547(c)(2)[5] will provide a defense for subcontractors receiving payments in the ordinary course, but if payment is not made in the ordinary course, then the subcontractor has a remedy at law available to it to obtain a lien by complying with North Carolina's statutory provisions. This case should not be elevated to review by the highest Court in the land simply because United Rentals chose not to exercise its rights under state law, and asserts a "decision of national importance" because it chooses, with knowledge of the Fourth Circuit's ruling, not to exercise those rights in the future. The right that United Rentals contends to be of national importance is the right to retain a preferential payment in cases where it has leased equipment on construction projects in North Carolina and knowingly refuses to assert the rights granted to it under North Carolina lien laws to protect its rights to payment.

Furthermore, United Rentals has failed to show any case without distinguishing facts from any other circuit allowing the § 547(c)(1) new value defense. The Second Circuit cases interpreting *Ricotta* hold that it is irrelevant to the new value defense or to cases in which the creditor asserts a lien against property that is not property of the debtor. The Ninth Circuit case of

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[5] United Rentals did not assert the ordinary course of business defense under 11 U.S.C. § 547(c)(2) in this case.

Greenblatt is based on a now-repealed statue that grants an absolute lien without notice provisions. United Rentals has simply cited no conflicting Circuit Court decision on point.

Bond claims. Similarly, the "decision of national importance" as to bond claims is the right to retain a preferential payment in cases where it has leased equipment on construction projects and knowingly refuses to assert a claim against the surety that agreed to pay its claims. The alleged damage to United Rentals in having to return the preferential payment is uncertain in view of the ability of United Rentals to make a contingent bond claim against the surety for payments made within the preference period – possibly providing it with a source of recovery even if the preference payment is avoided.

Public Policy. As to both issues, United Rentals asserts that the Fourth Circuit's holding will encourage creditors to file lien claims and assert bond claims to avoid bankruptcy preference claims would disrupt projects and business relations, generate legal fees and consume court resources, while promoting rather than preventing dismemberment of the debtor during his slide into bankruptcy. Brief, p. 35. Certainly, the Miller Act, the little Miller acts and the North Carolina lien laws were enacted by the legislatures to allow subcontractors and suppliers, such as United Rentals, the legal means to protect themselves in the event of nonpayment by a contractor or owner. They make remedies available to subcontractors to better their positions by obtaining rights to payment from third

parties or liens and encourage the very acts that United Rentals contends to be the evils that the Fourth Circuit Decision fosters.

Just as one unsecured creditor may obtain a judgment against a debtor while another does not, or a creditor may require security as a condition not extending credit while another does not, United Rentals is in the position of a creditor that, having remedies available to it, failed to exercise them. There is no public policy that would bestow upon United Rentals the benefits of remedies that it did not exercise to avoid the bankruptcy policy of making pro rata distributions to similarly situated creditors. To the contrary, allowing United Rentals, who did nothing to protect its position to change its position from an unsecured creditor to a secured creditor to reap the benefits of a security interest it did not have or an equitable lien that the surety did not have would be contrary to the equality of distributions among unsecured creditors.

CONCLUSION

The cases relating to §547(b)(5) are not in conflict and the conflicting rules of decision cited by United Rentals are uniformly found to be compatible in the same circuits. The "100% rule" applicable to unsecured creditors applies to United Rentals because it was found to be an unsecured creditor ad is a specific application of the ":diminution" rule.

As to the issues under § 547(c)(1), United Rentals did nothing to assert claims against bonding companies on the projects or to obtain liens that are available under

North Carolina law. This was the factual basis of the Fourth Circuit decision and was integral to its legal conclusions. In arguing that there are conflicts between the circuits, United Rentals relies on cases in which creditors had actual liens or asserted claims against bonding companies. These cases are not controlling in their circuits as to § 547(c)(1) in cases where no bond claims had been asserted and there were no liens. There are simply no circuit court decisions cited by United Rentals that are factually on point with the Fourth Circuit decision.

The issues involved are not of national significance, since North Carolina's lien laws are specific to North Carolina and a creditor may protect itself by utilizing its remedies to make bond claims or file liens. United Rentals' petition for certiorari should be denied.

Respectfully submitted,

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No. 09-1417

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IN THE

Supreme Court of the United States

UNITED RENTALS, INCORPORATED,

Petitioner,

v.

JAMES BIGELOW ANGELL,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

REPLY BRIEF

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STATEMENT PURSUANT TO RULE 29.6

Petitioner's corporate disclosure statement was set forth at page *ii* of its Petition for a Writ of Certiorari, and there are no amendments to that statement.

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REPLY BRIEF FOR THE PETITIONER

Despite acknowledging that diminishment of the estate remains an element of a preferential transfer, the Trustee relies on the "100% rule" and the classification of United Rentals as a "general unsecured creditor" at the time of the transfers as the decisive analysis in this case. This argument merely highlights the flaws in the court of appeals decision. While this "100% rule" may generally apply, the statutory and contract rights possessed by United Rentals render the rule inapplicable when a court is required to consider the actual effect of the transfers on the bankruptcy estate.

The Trustee also presents a number of reasons why the policy implications of the Fourth Circuit's decision should not concern contractors and suppliers throughout the construction industry. While these suggestions may present some protection to these members of the construction industry, they do very little to alleviate the real world impact of this decision. If this decision is allowed to stand, contractors and suppliers risk being denied the protection of mechanic's lien statutes and payment bonds not by the fact that a bankruptcy was filed, but rather by the fact that these contractors or suppliers accepted payment for their work prior to the bankruptcy filing. This Court should grant certiorari to review this inequitable and illogical result and prevent its wide-ranging implications in the construction industry.

I. The Fourth Circuit's decision under § 547(b)(5) relating to United Rentals unasserted bond claims conflicts with the decisions of the Sixth Circuit and other circuits.

A. The "diminution rule" and the "100% rule" are in direct conflict in this case.

The Trustee argues that "[a]lthough the diminishment rule generally applies in determining whether § 547(b)(5) applies, the 100% rule is a special application of that rule applicable to unsecured claims such as the claims of United Rentals in this case." Brief in Opposition p. 19 (hereinafter "Opposition"). The premise underlying this position is that a transfer to a creditor who is determined to be a general unsecured creditor *always* results in a diminishment of the estate unless the bankruptcy estate is sufficient to pay all of the general unsecured creditors in full. While this may be accurate in most bankruptcies, the rights created by mechanic's lien statutes and payment bonds create a situation where this premise fails.

In *Palmer Clay Products v. Brown*, 297 U.S. 227 (1936), this Court numerically analyzed the effect of a transfer on the estate. *Id.* Looking to language from section 60 of the Bankruptcy Act, this Court determined that the hypothetical creditor there would receive "a greater percentage of his debt than any other of such creditors of the same class." *Id.* This quoted language is not a part of the modern Bankruptcy Code. *See* 11 U.S.C. § 547 (2010).

In a chapter 7 liquidation, the estate available for distribution to all creditors is a finite amount. The estate available for distribution to general unsecured creditors

is that finite amount minus the amounts paid to creditors with higher priority claims. Where a creditor has no recourse against the third party, the "diminishment rule" and the "100% rule" reach the same result.

The circumstances presented in the instant case are factually distinct from *Palmer Clay Products*. Had the alleged preferential transfers not been made, United Rentals could have asserted a claim against the payment bonds on the projects between the dates of the transfers and the petition or post petition and been paid by the surety. Per this Court's decision in *Pearlman v. Reliance Insurance Company*, 297 U.S. 227 (1936), the surety would have then had an equitable lien on any funds earned by the debtor on the project and those funds would have never become property of the estate. As a result, the transfers would not have been part of estate if United Rentals had not received them, but rather property of the surety. Because the total value of the estate, the total amount of secured or priority claims and the total amount of unsecured claims remains constant whether the transfer was made or not, the transfer did not diminish the estate available to unsecured creditors. As required by this Court in *Palmer Clay Products*, the *actual effect of the payment as determined when bankruptcy results* in the instant case is that the estate available for distribution to unsecured creditors is identical if United Rentals received the transfers or if it did not.

Consequently, the "100% rule" as applied in this case and advocated by the Trustee, is not a "specific application of the diminishment rule" but rather in direct

conflict with the diminishment rule. As noted extensively in the writ filed in this matter—and conceded by the Trustee in its Brief in Opposition—various circuits hold that diminishment of the estate is an element of § 547(b). None of the lower courts in this case required the Trustee to establish this element or even considered diminution as an element of § 547(b), but rather relied strictly on a classification of United Rentals as an unsecured creditor. For this reason, the Fourth Circuit's decision is in direct conflict with the Sixth Circuit and various other circuits and warrants this Court's review.

B. Deciding § 547(b) based upon a determination made at the time of the transfers conflicts with clear precedent of this Court and the Sixth and Tenth Circuits.

Not only does the application of the 100% rule conflict with the Sixth Circuit and other circuit court precedent identifying diminishment as an element of § 547(b), the analysis underlying the application of this rule in this case directly conflicts with precedent of this Court and the Sixth and Tenth circuits.

As the Trustee notes, in deciding whether the Trustee had met his burden under § 547(b), "the Fourth Circuit treated United Rentals as an unsecured creditor." Opposition p. 19. Also, the Trustee argues, "[t]he Fourth Circuits decision . . . is expressly based on its affirmation . . . that United Rentals was an unsecured creditor when the payments were received." Opposition p. 12. This Court's decision in *Palmer Clay Products* is clear that when determining whether a transfer is preferential, the analysis is performed at the time of

the bankruptcy petition, *not at the time of the transfers*. 297 U.S. at 227. The Sixth and Tenth Circuits also agree that the § 547(b) is to be analyzed as of the date of the petition. *See Sloan v. Zions First National Bank (In re Castletons)*, 990 F.2d 551, 554 (10th Cir. 1993) (holding "the petition date is the relevant date for purposes of the hypothetical creditor test under 547(b)(5)"); *Neuger v. United States (In re Tenna Corporation)*, 801 F.2d 819, 822 (6th Cir. 1986) (stating that the date of the petition is the date "that a payment should be tested").

While this case remains rife with confusion, the case law is clear that identifying United Rentals as an unsecured creditor at the time of the payments is meaningless in applying the required test under § 547(b). If, as the Trustee argues, the 100% rule can act as an exception to the Sixth and other circuits holdings that Trustee must show actual diminishment of the estate to establish § 547(b), the manner which it was applied in this case was in conflict with precedent of this Court and various circuits. Thus, review by this Court is warranted.

II. The decision below implicates reoccurring issues of national importance.

A. United Rentals and other creditors holding inchoate mechanic's liens and payment bond rights at the time of any allegedly preferential transfers are prejudiced by the receipt of those transfers.

In his Statement of the Case, the Trustee argues that "the prejudice of recovery of a preferential payment is no greater than that applicable to a general creditor, including a general unsecured creditor that could have obtained a judgment lien or other lien, but failed to do so." Opposition p. 9. United Rentals received the transfers on June 14, June 30 and July 20. On those dates, no creditor could have obtained a judgment lien against the debtor as the attachment of such a lien within the ninety days prior to the bankruptcy filing would itself be a preference. *See e.g. Carlson v. Rose (In re Rose)*, 88 B.R. 193 (Bankr. W.D. Mo. 1988). Here, in order for a judgment lien to be valid against assets of the debtor, that judgment lien would have had to be attached no later than June 3, 2004. Because the dates of the transfers are well beyond the dates a judgment lien could have attached to assets of the debtor, it is certain that preferential transfers cannot and do not prejudice a potential judgment lien creditor.

In stark contrast, it is undisputed that on the dates of the transfers United Rentals could have perfected its inchoate mechanic's liens or made a claim on the payment bonds. As of the dates of the transfers, United Rentals had neither slept on its remedies nor foregone

the opportunity to pursue those remedies had they not received the transfers. The only events that prevented United Rentals from taking advantage of these remedies were the transfers. Thus, unlike a judgment lien creditor, the prejudice faced by United Rentals was a direct result of the transfers.

This prejudice is most poignant when you consider the impact of the transfers on United Rentals rights under state law. United Rentals last supplied rental equipment on the projects relevant in this case on June 1 and September 22, 2004. As a result, the applicable deadlines under state law and the payment bonds are well beyond when the transfers were received. Under the Fourth Circuit's ruling these deadlines are changed drastically. The Fourth Circuit would require United Rentals to have perfected its liens or made claims against the bonds by the dates the transfers were actually received—June 14, June 30 and July 20—or lose the protection of these statutes and bonds. The modified deadlines created exclusively by the fact that United Rentals received the transfers are prejudicial to United Rentals and, under the Fourth Circuit's opinion, detrimental to their ability to exercise their bond rights or perfect their inchoate liens.

In contrast to this result, § 547(b) demonstrates a clear congressional intent that creditors not be prejudiced by the receipt of a transfer by requiring that the preference analysis be performed as if "the transfer had not been made." *See* 11 U.S.C. § 547(b)(5)(b) (2010). Similarly, § 546(b) demonstrates the congressional intent to protect a creditor, like the holder of an inchoate mechanic's lien, "that acquires rights in such property

before the date of perfection." *See* 11 U.S.C. § 546(b) (2010). Here, the fact that transfers were received was the sole cause of the prejudice faced by United Rentals and United Rentals unquestionably would have been better off had it not received the transfers. This result is both inequitable and inconsistent with the intent of the Bankruptcy Code.

B. The ordinary course of business defense does not alleviate the prejudice created by the Fourth Circuit's ruling or provide a viable means of protection for creditors with inchoate liens or payment bond rights.

The Trustee further asserts that the ordinary course of business defense created by 11 U.S.C. § 547(c)(2) will protect mechanic's lien or bond claimants from being prejudiced by accepting payment. Opposition p. 36. He argues that if a contractor does not receive payments within the "ordinary course" it can then exercise its other remedies. *See* Opposition p. 36 (advocating this Court should not review this case because United Rentals could exercise its lien and bond rights in the future).

The ordinary course of business defense requires a court consider "several factors, including timing, the amount and manner a transaction was paid and the circumstances under which the transfer was made." *Yurika Foods Corp. v. U.P.S. (In re Yurika Foods Corp.)*, 888 F.2d 42, 45 (6th Cir. 1989). Late payments are considered particularly important in this analysis. *Marathon Oil Co. v. Flatau*, 785 F.2d 1563, 1567 (11th Cir. 1986). The Trustee asks that contractors or suppliers

track all of these factors, establish an ordinary course of business for each customer and immediately exercise its mechanic's lien or bond rights when a payment fails to be made within that time period with the hope that its internal analysis will match that of the court.

In this case, United Rentals received payments on June 14, June 30 and July 20 of 2004. These three payments encompassed forty-five invoices related to the projects with thirty-four unique invoice dates ranging from January 3, 2004 until April 13, 2004. Under the system argued by the Trustee, to fully protect itself United Rentals needed to perfect thirty-four liens and make thirty-four bond claims on the date each invoice moved beyond the "ordinary course." The same would be true of every supplier or contractor on any project who wanted to retain the protections created by state statute and payment bonds. Moreover, creditors that are paid earlier than the "ordinary course" are similarly unable to take advantage of this defense. In fact, under the Fourth Circuit's decision the only way for a creditor to be protected is to file a bond claim or perfect a mechanic's lien immediately after credit is extended to ensure that this remedial action precedes payment. Under the Fourth Circuit's opinion, the race to the courthouse to dismember the debtor begins immediately upon the extension of credit and the ordinary course of business defense will do nothing to slow this down.

C. The Trustee's proposed "contingent bond claim" is not a viable solution.

The Trustee's argument that United Rentals could make a "contingent bond claim against the surety for payments made within the preference period" is similarly without validity. This solution does not solve the problem of the sheer volume of bond claims that will be made and the effects of those claims on construction projects and the debtor when sureties make claims on money owed to the debtor in an effort to limit their exposure. These claims by sureties will stop the flow of funds to the debtor on projects, thereby eliminating the debtor's cash flow and accelerating the slide into bankruptcy.

A "contingent bond claim" also does not provide a viable source of recovery "even if the preference payment is avoided." Most payment bonds establish a limitations period for filing suit to enforce a claim against the bond and the surety. The Miller Act requires that a claimant file suit within one year. *See* 40 U.S.C. § 3133(b)(4) (2010). The North Carolina Little Miller Act requires the same thing. *See* N.C. GEN. STAT. 44A-28(b) (2010). This case, like many if not most preference avoidance actions, was filed nearly two years after bankruptcy was filed. By that time, any contingent bond claim would have been rendered useless unless a creditor has also filed a "contingent" lawsuit for sums it had already been paid. Again the Trustee's proposed system inflates legal costs to both creditors and the debtor and results in a race to the courthouse to dismember the debtor.

CONCLUSION

Had it not received the transfers, United Rentals could have enforced its bond rights or perfected its inchoate mechanic's liens either between the dates of the transfers and the petition date or after the petition date. United Rentals would have then been paid in full. The assets available for distribution to general unsecured creditors would be equivalent in either of these circumstances because of contingent secured or rights against estate assets by the general contractors and surety. Consequently, United Rentals is no better off and the estate is no worse off for the prepetition transfer. This is very different from the general unsecured creditor that could have sought a judgment lien prepetition, but elected not to. Indeed, a judgment lien obtained during the preference period could be avoided. Unlike a potential judgment lien creditor, the prejudice faced by United Rentals and other creditors holding inchoate liens or bond rights is a direct result of having received the transfers. Here, the "100% rule" fails to take into account the actual result of the transfers on the estate and conflicts with various circuits that require diminishment of the estate as an element of § 547(b).

Despite the opportunity to point out to this Court why the Fourth Circuit's decision will not cause suppliers and contractors to disrupt construction projects through the filing of mechanic's lien and bond claims, the Trustee has only pointed out why the other defenses available to a supplier or a contractor will further encourage a race to the courthouse and accelerate the debtors slide into bankruptcy or why those defenses fail to protect a

supplier or contractor from exposure. As noted in United Rentals' writ and unsuccessfully rebutted by the Trustee in his brief in opposition, the public policy implications of the Fourth Circuit's decision on the construction industry are dire and far-reaching. This decision conflicts with decisions of this Court and other circuits and threatens to disrupt both public and private projects throughout the country.

Review by this Court is necessary to prevent such inconsistent application of the Bankruptcy Code and the resulting consequences. United Rentals' writ should be granted and the decision of the Fourth Circuit overturned.

Respectfully submitted,

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